

LONG-DISTANCE COMPETITION

HEARING

BEFORE THE

SUBCOMMITTEE ON COMMUNICATIONS

OF THE

COMMITTEE ON COMMERCE, SCIENCE,

AND TRANSPORTATION

UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

STATE OF COMPETITION IN THE LONG-DISTANCE TELEPHONE
MARKETS

SEPTEMBER 5 AND 11, 1985

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LONG-DISTANCE COMPETITION

THURSDAY, SEPTEMBER 5, 1985

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE,
AND TRANSPORTATION,
SUBCOMMITTEE ON COMMUNICATIONS,
Washington, DC.

The committee met, pursuant to notice, at 10 a.m., in room SD-628, Dirksen Senate Office Building, Hon. Barry Goldwater (chairman of the subcommittee) presiding.

Staff members assigned to these hearings: Dale Brown, professional staff member; Regina Keeney, staff counsel; and Tom Cohen, minority staff counsel.

OPENING STATEMENT BY SENATOR GOLDWATER

Senator GOLDWATER. The meeting will come to order. Before we start, I'd like to apologize for not being able to hold this meeting in conjunction with the meeting that we are going to hold later on which might develop into a series of meetings. It depends on what develops.

The purpose of the hearings today is to provide the committee with a perspective on the state of competition in the long-distance telephone markets. We haven't had legislation introduced so far into this general area because, frankly, we haven't had any specific—and I mean specific—needs shown as to where the legislation should apply or what it should accomplish.

I believe that as time goes on, this need will become more and more obvious. Also, there is a lot to be desired yet in the field of operation, and this, of course, comes from the user, the person in the field.

Although I continue to believe that the breakup of AT&T was a great mistake, I think these hearings will enable us to closely examine the issues at hand and preclude the need for any legislative effort in this area. I would hope that would be true because it can get terribly political and when you get matters like this that are both technical and political, politics usually win and the user loses.

On that note, I'd like to ask Senator Gore if he has a statement?

OPENING STATEMENT BY SENATOR GORE

Senator GORE. Mr. Chairman, I want to commend you for holding this series of hearings. Whether we agree with AT&T or with the compliants of its competitors as they try to penetrate the long-distance marketplace, it is should be clear that the upheaval

caused by this new competitive landscape has brought confusion and economic uncertainty to these companies and their customers.

This confusion and uncertainty are only the latest byproduct of this Government's breakup of our national telecommunications system. We were told that competition will provide untold benefits for consumers. Well, for the vast majority of telephone customers in this country, these benefits are indeed untold, at least so far.

As yet, the benefits amount to rapidly rising local telephone rates and the economic hardships they have wrung from older citizens, small businesses, the poor, and just about any telephone customer who is not among the Fortune 500.

We were told that competition among long-distance providers would dramatically lower long-distance charges. But in my State, Tennessee, the competitive services have decided to stay away from all but the largest cities. More than half of my constituents have yet to see the benefits of this new competition.

Last year the FCC decided that all telephone customers—whether they make interstate calls or not—should be forced to pay an access charge to subsidize the competition in long-distance services. One excuse for this abrupt shift in subsidies was that the access charged would reduce the potential for bypass, the greatest threat to the local telephone company revenue base.

Yet we are told that bypass continues unabated and that the FCC has yet to approve a single telephone company experiment in bypass control.

I am not insensitive to the economic and competitive problems facing the OCC's at this stage in their growth. I recognize that their ability and willingness to serve rural customers is sort of a chicken-and-egg situation. And I understand their argument that AT&T is still the dominant heavyweight in this business and that the FCC should exercise caution in unleashing AT&T without any regulatory controls.

But my overriding concern is this question:

Are we headed down a blind alley of deregulation that could leave consumers with only one or two long-distance carriers, a kind of unbenevolent oligopoly contributing little or nothing to the integrity of local telephone service?

The predivestiture telephone system in this country may not have offered wide open business opportunities for all comers. But it did do this: It provided dependable, low-cost local basic telephone service through a system of predictable cost and revenue allocation. What we have now is far different.

Divestiture is a reality. Competition is here to stay. So our task now is to put into place policies which will manage this transition from a system that worked to one that will hopefully also work, despite the widespread hardships and inconveniences it is causing.

I am anxious to hear from the witnesses, especially the FCC, to learn whether present policies are working to solve the problems, or contributing to the problems facing telephone customers everywhere.

Thank you.

Senator GOLDWATER. The first witness we have this morning is Mr. David Markey, Assistant Secretary of Communications and In-

formation, National Telecommunications and Information Administration. Mr. Markey, you may proceed as you desire.

When 10 minutes has gone by, the red light will show up.

STATEMENT OF DAVID J. MARKEY, ASSISTANT SECRETARY FOR COMMUNICATIONS AND INFORMATION, NATIONAL TELECOMMUNICATIONS AND INFORMATION ADMINISTRATION, DEPARTMENT OF COMMERCE, ACCOMPANIED BY DR. ROBERT PEPPER, ACTING ASSOCIATE ADMINISTRATOR; AND RICHARD FIRESTONE, ACTING CHIEF COUNSEL

Mr. MARKEY. Thank you, Mr. Chairman. Let me introduce to you, to start my statement, two members of our staff who are accompanying me here today: Dr. Robert Pepper who is from our Office of Policy Analysis and Development; and Mr. Richard Firestone with our Chief Counsel's Office. They may be able to add a few words of wisdom to this proceeding this morning.

We appreciate the opportunity to briefly discuss some of the issues regarding competition in the long-distance telephone business. In July of this year, as the committee knows, we released a report stating the Department of Commerce's views on U.S. domestic telecommunications policies.

One key topic that we addressed was the importance of fostering more effective competition in the long-distance and other telecommunications sectors. For more than a decade, Federal policy has consistently sought to provide both business and residential telephone users more communications options and choices.

We believe that these procompetitive Federal policies have, on balance, produced substantial benefits. With competition, the range of communications services—voice, data, facsimile, and video, for example, has rapidly expanded. The available evidence also indicates that long-distance competition has stimulated overall demand and thus made the market grow faster than it would have under sole source or monopoly conditions.

Between 1976 and 1981, for example, the rate at which long-distance revenues increased each year roughly doubled, from about 6 percent to more than 11 percent a year. Since long-distance prices were relatively stable during these years, this doubling of annual growth rates suggests that traffic volume growth also roughly doubled during this period of growing competition.

We think this demand stimulation phenomenon is important. It furthers more efficient use of the capital and other resources we as a nation have invested in telecommunications. Increased use of our telecommunications system, moreover, generally means each individual user must contribute less toward the recovery of fixed costs. Thus, the price for service can be lower.

In recent years, the companies competing with AT&T in the inter-LATA long-distance telephone business have enjoyed increased competitive opportunity. Some companies have encountered difficulties, though these have varied from firm to firm. Indeed, AT&T itself has encountered difficulties maintaining its profits and meeting requirements for some classes of service.

Some of the difficulties that the competitive carriers have faced include increased local exchange access costs. Here, the discount

that non-AT&T companies once enjoyed has narrowed from about 75 to 55 percent.

Usage measurements are also a factor. The competitive carriers have begun paying for access on the basis of actual rather than assumed or hypothetical use. This has increased costs for those carriers which pack lots of traffic into local lines, and reduced costs for those which make less intensive use of local facilities.

Equal access problems have arisen as Bell operating companies have implemented the equal access requirements of the AT&T consent decree. These include technical problems and difficulties with attracting as well as holding onto customers.

And, price competition is a concern. AT&T has shown itself to be a more aggressive and effective price competitor than many initially forecast. This evidently has affected the growth rates of some of AT&T's toll competitors.

These are matters which concern us at the Department of Commerce. The telecommunications industry, as you pointed out, is in the midst of a complicated transition as it moves toward more cost-based pricing for all services. The equal access requirements under the AT&T consent decree involve adjustments and changes which are somewhat unprecedented. Involved are changes in the services provided to tens of millions of phone users, and changes which have to be made over a relatively brief period of time.

Both the industry and the public have experienced major changes in the past, however. The shift away from using operators, to being able dial local calls directly, for example, caused problems in the 1940's and early 1950's. The introduction of direct dial long-distance service in the 1950's also created a lot of transition problems.

Equal access conversion, like these other changes, will require adjustments by all parties concerned.

Some of the financial problems affecting competitive carriers are also not just due to these equal access and related problems. They are a function of company decisions to undertake major construction programs during this transitional time.

Faced with increased local access cost, plus more aggressive AT&T price competition, the result has been lower or, in some instances, zero profits.

In 1983, we participated in the FCC proceedings which involved increasing the local access charge placed on the competitive carriers. We urged the Commission to phase in the increases involved, and the FCC subsequently agreed to do so.

We also urged the FCC in 1984 to sanction industry working groups composed of all the local and long-distance companies, with a view toward informally ironing out some of the technical questions which have arisen. In the domestic policy report we just released, we endorsed recent actions by the Justice Department which stipulate that equal access obligations will not be considered satisfied until customer order information is provided to the competitive carriers.

We are committed to ensuring that the transition now underway proceeds in a manner which affords each company a fair opportunity to compete in the marketplace, and to succeed or fail based on

its ability to satisfy user demands. In this regard, we would urge the subcommittee to bear the following points in mind.

First, company failures, mergers, consolidations, as well as new entry, usually are indications that a market is competitive. The more competitive a given market, the more failures one may see, since the possibility of a failure is one of the risks inherent in a competitive marketplace. Indeed, it is this very risk of failure that we generally rely upon in our economy to spur companies to put forward their best efforts.

The absence of marketplace risks is common only in tightly regulated, monopolistic businesses.

Second, we should not lose sight here that our goal is to promote competition, not the commercial fortunes of individual competitors. Companies can compete and injure each other financially to a significant extent, and the public can still come out the winner.

Government should only become concerned when financial injury to a given company or group of companies seriously threatens to reduce the competitive options available to consumers.

We see little significant risk at this point that telephone customers will be denied the competitive long-distance service choices that they now enjoy.

Third, we do not attach at this point much weight to the argument that Government must take special actions to prevent remonopolization of the long-distance telephone business. Our analysis of costs shows no major area where any one firm enjoys or is likely to enjoy a decisive advantage in this sector.

Fourth, while we at Commerce from time to time have disagreements with the Justice Department and with the FCC, in this situation we've generally supported the positions and actions that they have taken.

Mr. Chairman, this is not an area where there are a lot of clear-cut solutions which will satisfy everyone. People are entitled, however, to a full and fair consideration of their problems. I believe that if one reviews what the FCC and the Justice Department have done with respect to promoting long-distance competition, the record will show that they have tried to deal fairly with all parties and, as importantly, tried to keep the public's interests in the forefront.

That concludes my prepared statement, Mr. Chairman, with one final comment that I want to make, in the interest of full disclosure. I want to make the committee aware that in my own personal situation, I have been talking to a large telecommunications company which is not in the inter-LATA business, I might add, at this stage, and I want to make the committee aware of that. There is no final agreement between us, and there may not be, but I want to disclose that to the committee so that you will understand I am doing that.

The views I represent today are those of the Department of Commerce. They are the ones that are reflected in our study that was released in July. But I wanted to make the committee aware of that.

Senator GOLDWATER. We thank you for that observation.

Do your compadres have anything to add?

Mr. MARKEY. I think they are here to help me answer your questions, sir. If they do, I will be happy to let them.

Senator GOLDWATER. I just have a few questions. I am still waiting for the chairman to show up, but it is a long way over here.

Do you feel AT&T's competitors are having a hard time competing and, if so, why?

Mr. MARKEY. Well, I think they are to a certain extent having a difficult time competing, but I think any time you enter a business like the long-distance telephone business, where one company like AT&T has been a very strong and predominant company for so long, that there are going to be difficult times.

Competition, as I said in my statement, means that there will be people who will fail because of that competition. But yes, sir; I think that there are problems out there in some areas. Some of those problems will tend to solve themselves. As indicated earlier in my prepared statement, we're going through something here that's a little unprecedented.

The local exchange companies, the Bell operating companies that are having to provide the equal access, have never had to go through this before. And, obviously, any time you do something like this for the first time where you are involving, really, millions of people, every telephone user in the country virtually, you are going to have some problems.

So I think they are experiencing some problems. I think they are problems that the FCC is looking at, and the Justice Department is looking at them. Obviously, this committee is looking at them. So I think there are problems. I think they should be looked at. But we do not see any that would indicate to us that we are still not going to have a competitive communications marketplace 3 or 4 or 5 years from now.

Senator GOLDWATER. Thank you.

Senator Gore, if you have questions, I will wait for you or—

Senator GORE. Either way, Mr. Chairman. I have a few questions, but I am patient and I would be glad to—

Senator GOLDWATER. Go right ahead.

Senator GORE. All right, let me just ask a few brief ones, then. Thank you.

In your study, Mr. Markey, you seemed to imply that the FCC is going too far in insisting, separation between the regulated and nonregulated services of AT&T and the regional companies.

That assertion seems to be quite different because it flies in the face of the complaints and many who believe that the FCC has not done enough to ensure clear competition between those companies and their competitors.

Would you agree with that? It does seem that way, doesn't it?

Mr. MARKEY. No, it doesn't seem that way to me when I look at it from the aspect of the public. It may seem that way when you look at it from the aspect of certain competitors who believe in the old Washington maxim that we all know so well, which is "all I want is a fair advantage."

I do not mean to be flip about this, but we have competing interests here, I think. And there is no easy answer to that issue. But what our report found was that in the interests of the public, and in the interest of reducing cost to the public, it probably made

more sense to try to find other regulatory mechanisms to deal with some of these problems rather than separate subsidiaries, which I think you are referring to.

Obviously, when you make corporations set up separate subsidiaries, you are creating costs. And those costs can be quite substantial. What we found was that probably in most cases it made more sense to find other ways to deal with some of those problems than to create these very costly separate subsidiaries.

Those costs, obviously, are passed on to the public. And so that is where we came down. We felt that as far as the public was concerned, there were other ways to regulate these possible abuses, other than creating these separate subsidiaries.

Senator GORE. Would rapid elimination of the separation protections drive any of the competing companies out of business?

Mr. MARKEY. Well, you are asking me to predict something that I am not sure I can predict. I don't know whether it would or not. As I indicated in my statement, I think that if we are going to have truly competitive markets, some people are going to go out of business; there are going to be consolidations.

As you know and as I know—I have served in Government twice in the Senate as a staff person—if I had a nickel for everybody that came in and told me they were going out of business because of some government regulation, I could retire.

So whether that will be the case or not, I just cannot predict. But obviously, if it is a competitive market, some people are going to compete better than others. They are going to be better businessmen. They are going to have more success than others, and that is a danger; yes, sir.

Senator GORE. Well, let's look at it from the standpoint of consumers, both residential and business. Do they benefit or lose from the elimination of separations?

Mr. MARKEY. Of separations? Of separate subsidiaries?

Senator GORE. Yes.

Mr. MARKEY. I think the public benefits when we remove the separate subsidiary requirements, because as I indicated, I think they create vast costs that are then passed on to the public. It seems to me that the better way to do this, and we have suggested some better ways to the Commission, is to make sure there is equal access; make sure that the services are unbundled; make sure that we have very strict accounting rules and that those accounting procedures are audited.

And, we think that would create much less cost that would then be passed on to the public. Obviously, there is a balancing here of interests. You have to balance the interest of trying to preserve competition which measure is something that we all want, against the interests of which measure is going to benefit the public to the greater extent. We found that reducing these costs, we felt, would benefit the public to a greater extent than the separate subsidiaries.

Senator GORE. All right, thank you.

Your study made reference to the growing trade problems of our country. Has divestiture increased or reduced those problems?

Mr. MARKEY. Well, I think at the moment, I would have to say that divestiture has probably increased those problems, and for this

reason: Before divestiture, the Bell System was an integrated system, and most of the equipment purchased by the local companies, the Bell Operating Co's, was produced by Western Electric.

Now that we have broken up the Bell System, those companies are going out and finding other sources of equipment. Some of those sources are foreign sources.

I might add that Secretary Baldrige is very concerned about this issue and has asked us to try and get some figures on just what has happened in this area. We asked the operating companies for some figures. Of course, they are very leery of giving out figures that could be considered proprietary, and we have assured them that the figures that they give to us would be used only in a cumulative way. But I think it would be very interesting to see just how much more we are purchasing internationally now than we were before the breakup.

Let me add one other thing, if I might. And that is that in our study we found the restrictions of the consent decree on the Bell Operating Co's, particularly as they pertain to them doing business overseas, do not make a lot of sense to us.

We can understand the need for restrictions where there is a bottleneck or where there is evidence of cross subsidies. But it did not make much sense to us for these companies to have to come to a Federal judge and the Justice Department before they can go overseas and do business.

Obviously, this is a very competitive international market, and we are competing with very large companies—Siemens, Ericsson in Sweden, Thomson-Alcatel, the Japanese companies, NEC, NTT. So our attitude is that if we have companies here that are large telecommunications companies that have expertise and resources, we should free them up to go do business in other countries if we can.

Senator GORE. Of course, some of those other countries have highly protected markets, and that is another whole story which I don't think we want to get into here, but I do want to express the hope that Japan's performance will follow their promises in this particular area. And given the current environment, it is in their interest that that occur, as well as ours.

One final question. If the regional telephone companies should be allowed to expand their operations, what services do you think they should be allowed to get into, and how soon?

Mr. MARKEY. As you know, right now, under the consent decree, the regional companies were approved by the court apparently with the idea that they would provide only local exchange, basic telephone service.

In our judgment, that tends to waste what I think are great national resources. They are prevented by the consent decree right now, for instance, from providing information services. Well, when you look at the telephone company and its base of customers—most of us have some kind of a relationship with a telephone company—if we are going to get some of these information services, it is our feeling that probably they are going to come from these local operating companies.

So to prevent them from using their facilities, it seems to us is something that probably ought to be looked at pretty closely and maybe changed in the consent decree.

We would also want to see, as I indicated before, the restrictions on what they can do overseas removed because we don't believe that those restrictions really further the purposes of the consent decree. We think that these companies should be able to go overseas and do the kinds of things that they have expertise to do.

Also, with respect to manufacturing, I think that once we have equal access, which will come in 1986 under the present schedule, unless something happens to push that back, we have recommended that at that time we ought to go back and look hard at whether some of these companies might not be permitted into manufacturing, primarily because of the threat of foreign competition.

If they can't manufacture and compete in some of these markets, what we are finding is that a lot of that business is going to companies from outside the United States.

Finally, with respect to inter-LATA competition, that is, the long-distance part of the business that goes across LATA lines, we think that once equal access comes into being, that again we should reconsider whether these companies should be able to provide long distance and not be restricted from providing the inter-LATA long-distance service.

I want to point out, by the way, that people, some people are under the impression that these companies don't provide long-distance service. Well, they provide 20 percent of all the long-distance service in this country. It's intra-LATA long distance, however. LATA's were created by the MFJ and they are very involved, and I don't think we want to get into talking about what they are all about.

But there are artificial restraints, so I think that each of those restrictions should be looked at quite carefully in the future. These companies do have expertise. It does not make a lot of sense to prevent them from doing anything outside of their regional areas in the long-distance business because there is no threat of a bottleneck.

Senator GORE. Thank you.

Thank you, Mr. Chairman.

Senator GOLDWATER. Thank you.

I think it is important that all Americans, not just those that live in big cities, or use a lot of long distance, see some benefits from the divestiture.

What can be done in your opinion to ensure that competitive long-distance service options are available for rural America?

Mr. MARKEY. Well, our study found what you just said, Mr. Chairman, and that is that competition has not come to many of the rural areas of this country. There are several points that maybe we could touch on here and maybe Bob or Rick have some other thoughts here.

One is, if in fact in the future we do allow the regional telephone companies, the local exchange companies, to get into the inter-LATA business, they may find it worthwhile in some of these areas that they serve that are rural areas to provide a competitive service. That is the first point.

The second is that we are finding some of the resellers out there—and this is coming about in the midpart of the country, I believe, in Indiana and some other places—are coming together

and purchasing switches and otherwise combining and trying to provide alternative long-distance services. But I would say at the moment, I think you are absolutely right. I don't know that we can show too many benefits of the divestiture to the rural residents as far as competitive services are concerned.

Senator GOLDWATER. Thank you very much. The chairman is here now, and I will submit the rest of my questions for your answers and you may make any statement you care to.

The CHAIRMAN. Mr. Chairman, thank you very much for holding the hearing. It is obviously an important subject that is of great concern to a lot of people, and witness the attendance here today.

I am here to listen rather than make any particular point. I have no statement to make, but I do thank you for holding the hearing.

Senator GOLDWATER. Well, that is very unusual. But I do thank you for being here.

Thank you very much, Mr. Markey, and your associates. We will submit these other questions for your answer.

Mr. MARKEY. Thank you, Mr. Chairman.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR GOLDWATER AND THE ANSWERS

Question. "Do you believe that ensuring effective long-distance competition is an important national goal?"

Answer. Competitive markets generally benefit society by encouraging faster development and deployment of new technologies and services, by ensuring closer correlation of prices and production costs, and by promoting more efficient use of capital and other resources. Competition also serves as a spur to make companies more responsive to the public. NTIA has long supported and advocated more effective competition in long-distance communications because we believe competition can be reasonably expected to yield substantial public dividends. Indeed, competition in telecommunications has already significantly benefited the American people.

This is not to say that the road toward more effectively competitive communications markets has been or will prove to be troublefree. As the telecommunications industry becomes more and more competitive, firms are likely to enter, exit, merge, or consolidate. Increased commercial rivalry here, as in other lines of commerce, tends to heighten business risks. Those companies most successful at meeting and anticipating customer demands, however, can also be expected to earn the greatest rewards in our competitive marketplace. It is this reward incentive that we generally rely upon throughout our free-enterprise economy to spur individual firm behavior to best serve the public's welfare.

The national goal is to promote effective competition, not necessarily to foster or protect the commercial fortunes of individual competitors. We believe, in this regard, that the best means of ensuring true competition in telecommunications, and the benefits likely to flow from it, is to permit companies to succeed or fail in the marketplace based on their ability to satisfy user demands, and not because of Government intervention.

Question. "The NTIA study states that the transition from monopoly to competition in the long-distance markets have been complicated by unanticipated problems. Are these problems being adequately addressed?"

Answer. The problems which have arisen are due chiefly to the difficulty of implementing one of the largest technical changes that the industry has experienced—the conversion to "equal access"—at the same time the largest firm, AT&T, was being restructured by the courts. Our monitoring of the equal access conversion process indicates, however, that the process today is moving more smoothly than was previously the case. Not all of the difficulties have been overcome. But "intraLATA" and "interLATA" companies are beginning to work together more effectively as they progress down the equal access "learning curve."

NTIA supports the Justice Department's efforts to make sure the transition to equal access proceeds in an efficient and fair manner. Not all "intraLATA" carriers have yet fully satisfied all the Justice's notification and information criteria but,

again, all indications are that the Bell Operating Companies are moving rapidly toward full compliance with those criteria. It must be borne in mind that the equal access process does entail altering records and technical arrangements with respect to literally tens of millions of dispersed telephone subscribers. Given the magnitude of this undertaking, even a very small error rate translates into a significant number of correctable mistakes.

The Federal Communications Commission (FCC) has acted to ameliorate transitional problems and inequities when presented evidence of significant problems. The FCC's recent "ballot/allocation" approach toward reducing equal access disputes indicates the FCC has been responsive to legitimate concerns. State regulators also have been reviewing marketplace conditions in their jurisdictions and several commendably have acted to ensure more effective competition in intrastate communications markets. Both Federal and state regulators are limited in what they can do, given the authorities of the antitrust judgment court. NTIA nevertheless is confident that most of the major outstanding difficulties are being adequately addressed by the responsible regulatory and other authorities.

Question. NTIA indicated in its recent study that prospects for long-distance competition are good. But your study also anticipates some consolidation of firms. After the shakeout, will there be enough competitors to ensure effective competition?

Answer. At this point in the transition, it is difficult to predict with precision the exact number of long-distance competitors that will remain after the current shakeout. There is also little agreement among economic and competition policy authorities as to what number of firms is needed to ensure competition. Indeed, some have suggested markets served by a very few—or even one—carrier may be effectively competitive as long as procompetitive, open entry conditions prevail.

Our economic analysis shows little ground to assume any hypothetical "remonopolization" of the long-distance telecommunications market is feasible. What evidence of scale economies exists is subject to risk of wide error; even if such economies prevail with respect to the transmission segment of long-distance service, that segment represents only a small component of overall service cost. Most competitive carriers and expert industry analysts believe any economies of scope or scale likely to have commercial significance can be achieved with just a market share of about 8 to 10 percent. One competitive carrier has represented that efficiencies can be achieved with as little as 4 percent of the nationwide market. And, of course, further competition can be provided by regional carrier or those serving "niche" markets.

Achieving effective competition in an industry so long dominated by a single firm obviously is not easy. Major changes have taken place, however, even in the relatively brief period since the AT&T divestiture. Two of the leading competitive carriers, one of the largest suppliers of customer premises terminal equipment, and the world's leading computer firm, for example, have essentially combined their talents and resources. The world's largest automobile manufacturer, the leading supplier of communications satellites, and a firm with demonstrated expertise at developing and managing sophisticated computer-data processing communications networks also have combined their resources. The resources and profits of IBM-Rolm/MCI/SBS and GM-Hughes-EDS, it should be noted, are substantially greater than those of post-divestiture AT&T.

Not only has new, competitive entry occurred, but, as one expert in this field has observed, the Government obviously has it within its power to forestall any hypothetical "remonopolization" of the long-distance business in the future by relaxing restrictions currently imposed on the seven regional Bell companies. Though their so-called intraLATA toll business, those firms now command some \$8.9 billion, or about 20 percent, of the total long-distance telephone business, or about twice the revenues and market share of all competitive common carriers combined. In addition to the Bell companies, the ability of the second largest telephone company, GTE, to compete in the communications marketplace is affected by restrictions also imposed by an antitrust consent decree which, presumably, could be relaxed. The presence of such substantial potential competitors "waiting in the wings" significantly undercuts arguments premised on an anticipated reduction or elimination of competition over time in this field.

Question. "When do you think AT&T and its competitors should pay the same price for local connections?"

Answer. NTIA supports the Federal Communications Commission's policy that there should be equal charges when there is substantial equality of access. Indeed, equal payment for equal access is one of the major underpinnings of the AT&T antitrust consent decree.

The "deep discount" afforded competitive carriers as a consequence of the ENFIA discussions in 1978 was premised on the fact that the quality of access available to

the competitive carriers was much lower than that available to AT&T. As this differential is eliminated, any non-cost based discounts should also be phased out. And we have endorsed the recent action by the Antitrust Division to ensure that equal access is effectively available to all carriers.

As we indicated in 1983 in comments to the FCC in support of the positions taken by the competitive carriers, every effort should be taken to minimize "rate shocks." The general policy should remain, however, one of equal payment by AT&T and the competitive carriers when equal access is substantially achieved.

Question. "If AT&T is allowed to price some services so that they don't contribute to overhead, which customers end up covering these costs?"

Answer. Virtually all disputes regarding the level of AT&T's prices and proposed prices have turned on the allocation of overhead costs, not the complete absence of such cost elements. In the unlikely event Federal (or state) regulators were to sanction prices which made zero contribution to overhead, overhead costs incurred in conjunction with such underpriced services might be borne by users of AT&T's less competitive long-distance offerings.

Increasing competition in almost all categories of long-distance service, however, further limits the ability of AT&T to shift overhead costs among classes of users. Over-allocation of costs and resulting over-high prices are likely to accelerate AT&T's loss of market share with the result that its shareholders would be the net losers.

Question. "When do you think it would be appropriate for the FCC to lessen its regulatory scrutiny of AT&T's rate reductions? Do you think the FCC should wait until equal connections are available to all long-distance carriers before it changes its standards for reviewing AT&T's rates?"

Answer. AT&T currently offers more than a dozen classes of long-distance communications service, and the level and intensity of competition varies significantly among these classes. The more competitive the class of service, most would agree, the less detailed regulatory scrutiny is warranted.

Most would agree, by the same token, that AT&T's message toll and wide area telephone offerings (MTS-WATS) are not yet fully subject to effective competition. As AT&T's market share continues to decline and conditions including the availability of equal access improve the prospects for actual and potential competitors, less detailed scrutiny of the prices and costs associated with these services may be appropriate. In the interim, and particularly until completion of the conversion to equal access, the FCC should continue closely to scrutinize proposed changes in AT&T's prices for such services, as we indicated in our recent Domestic Policy study.

Question. "Do you think deregulating AT&T too quickly will interfere with competition?"

Answer. AT&T and other "dominant" communications common carriers currently are and will remain subject to a diversity of Federal and State regulatory constraints. Some of these regulations unquestionably could be eliminated with little or no discernible adverse effect on the trend toward more effective, however, competition. The present requirement for approval of all facilities construction imposed under section 214 of the 1934 Communications Act, example, is one of the regulatory requirements we identified in filings with the FCC regarding long-run regulation that warrants reexamination.

Removing all regulation from AT&T prior to the advent of effective competition could interfere with competition. The fact that some regulatory controls may be necessary to facilitate competitive evolution, however, should not prevent commencement of a careful review to determine which costly, inefficiency generating rules and requirements might be discontinued. Significant "de-thicketing" of the present regulatory scheme, in short, should be possible without having an adverse impact on the trend toward competition.

Senator GOLDWATER. The next people to testify, we will have Mr. William Esrey, president of the United Telecommunications, Inc. from Kansas; Mr. Melvyn Goodman, president of CompTel from Chicago.

Gentlemen, you may be seated and proceed as you desire.

STATEMENTS OF WILLIAM T. ESREY, PRESIDENT, UNITED TELECOMMUNICATIONS, INC.; AND MELVYN J. GOODMAN, PRESIDENT, ALLNET COMMUNICATIONS SERVICES, INC., AND PRESIDENT, COMPTel, THE COMPETITIVE TELECOMMUNICATIONS ASSOCIATION

Mr. ESREY. Thank you, Mr. Chairman. There is essentially only one issue before the subcommittee today; the appropriateness of the Federal Communications Commission's present policies for regulating the long-distance telephone industry.

We believe that the Commission's current plan to bring about workable competition in the long-distance market cannot succeed. The plan lacks guidelines for the regulation of the dominant carrier, AT&T. It fails to define equal access properly and to effectively manage its implementation.

Finally, the Commission is currently allowing AT&T to unfairly underprice its services.

The Commission's focus on the short-term benefits of temporarily lower prices at the expense of lasting benefits derived from competition is not good public policy and prompts my appearance here today.

In 1983, the FCC commenced a proceeding, Docket 83-1147, to examine the market power of AT&T and to decide whether, when, and how AT&T should be deregulated. However, after taking comments on this docket, the Commission has consigned that case to cold storage.

The Commission has apparently chosen to deregulate AT&T for the tariff review process and its approved below-cost pricing schemes. By allowing AT&T to price below cost, the Commission is making it possible for AT&T to drive competitors out of the market. This strategy is not in the public interest because below-cost AT&T rates today will surely not produce low AT&T rates tomorrow if competition is eliminated.

The Commission has not adequately defined equal access. Instead, it has accepted a definition written by AT&T and the Bell Operating Co's. The result is that AT&T's competitors will pay rates equal to AT&T for access while receiving less in services and benefits than AT&T enjoys.

We are asking, therefore, that the FCC either reflect the difference in value received in access rates or make available to competitors the same services and benefits that AT&T receives.

Please understand that we are not asking for a subsidy. We are asking to pay only for what we receive and no more. One must bear in mind that there is no historical precedent for managing the transition of an industry from 100 percent monopolization to a truly competitive market structure. A competitive market, with market forces substituting for regulation, cannot exist when one competitor still dominates the market. AT&T today still has 90 percent share of the inter-LATA or the long-distance marketplace.

In the Joint Petition for Expedited Rulemaking filed in June, we asked the FCC to revise its current transition plan and to suspend consideration of additional below-cost AT&T pricing schemes until a finding could be made that these proposals, taken in light of all the issues that they raise, are or are not in the public interest.

I am repeating these requests to you today because we are concerned about our ability to receive an impartial hearing from the Commission. We want competition to survive and to supplant regulation. But unless the Commission changes its current policies, the public will be denied the benefits of competition and the turmoil of divestiture will have been in vain.

U.S. Telecom, our subsidiary, is investing \$2 billion over 4 years to build a nationwide, state-of-the-art, all digital, fiber optic network. This network will make it possible for the public to enjoy unprecedented quality in the transmission of voice, data, and video over the same network. It is technological advancements such as these which will enable the United States to strengthen its position in the Free world markets. It is vital that this potential not be carelessly sacrificed.

Deregulation is a means and not an end. We believe that the long distance market can be deregulated in a few short years, but only if the Government establishes a comprehensive, well-reasoned plan for the staged demonopolization of AT&T.

In summary, we ask that this subcommittee analyze the many-faceted issues that are presented by a matter that is as important and as unprecedented as the deregulation of AT&T and to adopt congressional guidelines that require the FCC to demonopolize the inter-exchange market in a manner that ensures that the public receives the maximum long range benefits derivable from competition.

I have filed with the subcommittee my written testimony which explains in more detail some of the issues that I have touched upon today and I would be happy to answer any questions that you may have.

[The statement follows:]

STATEMENT OF WILLIAM T. ESREY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, UNITED TELECOMMUNICATIONS, INC.

Mr. Chairman and members of the Subcommittee: I appreciate the opportunity to appear before the Subcommittee today to discuss matters that are of critical concern to US Telecom and most other competitive interexchange carriers.

My name is William T. Esrey. I am President and Chief Executive Officer of United Telecommunications, Inc. (United Telecom), a Kansas-based telecommunications holding company. I have held my current position since April, 1985; prior thereto, for four years, I was President of United Telecom Communications, Inc. (renamed US Telecom, Inc. in January, 1985), as well as Executive Vice President-Finance of United Telecom. Prior to joining United Telecom in 1980, I spent ten years with Dillon, Read & Co., Inc. in New York City. For almost five decades, the core business of United Telecom has been the United Telephone System; but I am here today to testify about the regulatory and economic issues and challenges facing US Telecom as it enters the competitive long distance business.

INTRODUCTION

US Telecom, a wholly owned subsidiary of United Telecom, was organized in 1982 to take advantage of significant opportunities presented by deregulation and divestiture in the long distance market. We are now well into the first of a three-year, two billion dollar effort to construct the nation's first all-digital fiber optic long distance telecommunications network. We are also currently aggressively establishing a presence in the market through the operations of three other affiliated corporate units. US Telecom-Communications Services Company (formerly U.S. Telephone) provides MTS and WATS-like services to residential and medium sized business users in over 85 major metropolitan areas throughout the United States. US Telecom-Corporate Network Services Company (formerly ISACOMM), based in Atlanta, provides high-

quality terrestrial voice and satellite communications services, including virtual private network, shared tenant, and videoteleconferencing services, by means of network facilities serving most major cities. US Telecom-Data Communications Company (formerly UNINET) is based in Kansas and offers a value-added packet switched digital data network connecting more than 400 cities.¹

Because our current market presence is comparatively small, the degree and timing of the deregulation of the dominant provider of long distance services, AT&T, is absolutely critical. It is critical not only to US Telecom, but also to all of the other competitive long distance companies. This is because AT&T has much more than market share: it has market power, the power to manipulate prices so as to restrict competition. Unless AT&T remains constrained from exercising this market power, it will devour the competition. At its present level of development, the competitive long distance industry cannot withstand either sustained, below-cost price cuts by AT&T or, conversely, sustained, substantial increases in our own business costs.

I am here today because two policies now being pursued by the Federal Communications Commission (FCC) are allowing AT&T to selectively drop its prices below cost and at the same time causing our own costs to rise precipitously. These two apparent FCC policy predicates are, first, that the expedited deregulation of AT&T allegedly serves the interests of the American consumer; and, second, that the Modification of Final Judgment's (MFJ) definition and schedule of equal access implementation are an appropriate plan for the transition to regulatory parity between AT&T and its competitors.

US Telecom fears that if the FCC is not made to promptly revise these policies, consumers will lose the low rates, high quality, and diverse new services that only meaningful competition can produce. The competitive long distance industry has pressed its arguments over and over again to the FCC, but the FCC has consistently refused to give them the consideration they warrant. And although a comprehensive rearticulation of our concerns is now pending before the FCC in the form of a petition for emergency relief,² collateral public statements of senior FCC decision-makers indicate that they may already have prejudged the merits of our complaints and that the FCC will deny our requests for relief once again.

Unless the Congress intervenes to compel the Commission to fulfill its statutory responsibilities to establish guidelines for the deregulation of the dominant carrier and manage the transition to competition, the competitive interexchange market that the MFJ intended to achieve will never be realized. If this happens, the American consumer will have endured the upheaval of divestiture for nothing. As a result of the FCC's apparent policies, the public may well be on the threshold, not of reaping the benefits of competition, but rather of suffering the consequences of the demise of competition and the reemergence of a market monopolized by AT&T.

THE LONG-DISTANCE MARKET

Competition

The history and current status of the interexchange communications market should be reviewed in order to put the urgency of the situation in appropriate context.

Competition in the provision of long distance services is a keystone of national telecommunications policy.³ For over 20 years the Commission under both Republican and Democratic Administration has followed a deliberate course of opening telecommunications markets to competitive entry. From the *Specialized Common Carrier* and *Resale and Shared Use* decisions,⁴ through the judicially-driven *Execunet* de-

¹ A copy of United Telecom's most recent Annual Report, describing US Telecom and its affiliates in greater detail, is provided as Appendix A.

² A copy of this Petition for Emergency Relief, filed jointly by GTE/Sprint, US Telecom, ITT, and Allnet Communications Services, Inc., is attached as Appendix B.

NOTE.—Appendix A-G have been retained in the Committee files.

³ See, e.g., U.S. Department of Commerce, *Issues in Domestic Telecommunications: Directions for National Policy*, NTIA Special Publication 85-16, issued by the National Telecommunications and Information Administration ("NTIA"), July, 1985 (hereinafter, "NTIA Report"), at 87: Most parties would by now agree that ensuring effective competition in the long-distance telecommunications field is an important national goal . . . The ability to select among alternative toll carriers constitutes an important component of the overall package of communications choices now generally available to the American public. That package, most would agree, should not be needlessly or precipitously altered.

⁴ *Specialized Common Carrier Services*, 29 FCC2d 870 (1971), *aff'd sub nom. Washington Utilities and Transportation Comm'n v. FCC*, 513 F.2d 1142 (9th Cir.), *cert. denied*, 423 U.S. 836 (1975); *Resale and Shared Use*, 60 FCC2d 261 (1976).

cisions⁵ and culminating in its *MTS/WATS Market Structure* decision,⁶ the Commission allowed open entry to the MTS/WATS submarket as the final step in its comprehensive pro-competitive regulatory program. In so doing the Commission reiterated the fundamental tenet of its open entry policies: that "competition and the elimination of barriers to entry . . . will ultimately result in the provision of telecommunications service at the lowest possible cost; in the reduction or elimination of waste; in making carriers more responsive to the needs and desires of consumers; and, in making carriers respond more rapidly and efficiently to technological change and innovation."⁷

Competitive Carriers

In response to these open entry policies numerous competing interexchange carriers entered the market, and are now providing a number of private and public switched long distance voice and data communications services.⁸ A critical fact of life for these companies is that, due to the extremely high initial cost of providing their own transmission facilities, they have historically had to utilize the long distance facilities and services provided by AT&T, as well as the exchange facilities provided by local telephone companies.

The competitive carriers' economically-dictated reliance on AT&T's and local carriers' transmission facilities has two significant ramifications. The most immediate is that it has resulted in a competitive industry dependent upon resale, with competition accordingly based on price rather than on technological sophistication or service innovation. Arbitraging of AT&T services has in turn been facilitated by FCC policies that permitted competitive carriers to pay less for interconnection to the local exchange network because of the inferior quality of these interconnection arrangements as compared to AT&T's.⁹ Discounted rates remain the chief advantage competitive carriers can offer to consumers. Consumers compare cheaper OCC service against the more expensive, but considerably more extensive, complement of services available from AT&T in selecting a long-distance carrier.

The other significant aspect of competitive carriers' reliance on AT&T's transmission facilities is that it differentiates the long distance telecommunications market from any other in which deregulation has been undertaken or enhanced competition has occurred. Competitors in the deregulated trucking and airline industries, for example, are much more evenly matched in size, facilities and service than AT&T and its fledgling competitors. Competitors in other markets that want to introduce new products and services do not need to depend on the facilities of the dominant competitor, as they do in the interexchange market.

CURRENT STATE OF COMPETITION IN THE LONG-DISTANCE MARKET

Competitive Carriers Generally

The long distance communications market has reached the point in its development at which competitive carriers have the chance to break their dependence on AT&T's transmission facilities. A number of competitive carriers are now constructing, or otherwise obtaining, transmission facilities that are completely independent from those of AT&T. Although these differ in extent and technological configuration,¹⁰ their development will mark the point at which competitive carriers will

⁵ *Execunet*, 60 FCC2d 25 (1976), *rev'd in part sub nom. MCI Telecommunications Corp. v. FCC*, 561 F.2d 365 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1040 (1978) (*Execunet I*), 580 F.2d 590 (D.C. Cir.), *cert. denied*, 439 U.S. 980 (1978) (*Execunet II*).

⁶ *MTS and WATS Market Structure: Report and Third Supplemental Notice of Inquiry and Proposed Rulemaking in CC Docket No. 78-72*, 81 FCC2d 177 (1980).

⁷ *Id.* at 202. And see *NTIA Report*, *supra* n. 3: "A competitive communications market is far more likely to deliver a broad range of services, precision-engineered to individual requirements, than would a return to a less competitive environment." *Id.*

⁸ The NTIA Report estimates that there are "some 300" competitive long distance companies. *Id.* at 86.

⁹ These interconnection arrangements are commonly referred to as "Feature Groups" because each is distinguishable in terms of the array of services each can provide. In ascending order of quality, these distinct interconnection arrangements are known as Feature Group A, Feature Group B, Feature Group C, and Feature Group D. Feature Groups A and B are the limited lower quality interconnections commonly provided to competitors; Feature Group C is the type of access AT&T has historically enjoyed; and Feature Group D is the nominally "equal access" to be provided all interexchange carriers under the MFJ. A tabular comparison of these feature groups appears as Appendix C.

¹⁰ See, e.g., *NTIA Report*, Table 2-1, "Selected Fiber Optic Developments, at 25. Subsequent to the publication of the *NTIA Report* Fibertrak, one of the companies included in the table, announced indefinite suspension of its network construction plans.

have the ability to compete squarely with AT&T on the quality and diversity of their services as well as on price. If, and when, these competing networks are completed it will signify the time when the long distance market will begin to resemble other product markets. At that point, and only at the point, will workable competition become a reality.

U.S. Telecom

The magnitude of the effort to procure independent transmission facilities should not be underestimated. U.S. Telecom plans to spend over \$2 billion, and utilize the combined talents of over 2,000 employees, to construct the nation's first all-digital fiber optic network. By its planned completion in early 1988, the network will consist of 23,000 miles of state-of-the-art fiber optic cable and other digital transmission facilities, electronics and switches, with a point of presence in every one of the 184 LATAs in the continental United States. Construction of the network is already well underway.

Many miles of cable have been laid along the first route, which extends from Chicago through St. Louis and Kansas City to Dallas. At the same time, as part of our arrangement with LIGHTNET, construction is progressing along the New York-to-Washington-to-Chicago route, and between Washington, Atlanta, and Jacksonville, Florida. Fiber between Jacksonville and Miami is already in place. We expect this segment of our network, from Miami north to New York, west to Chicago, and south to Dallas, to be in service by the end of this year.¹¹

AT&T

No look at the competitive interexchange market is complete without some comparative reference to the entity dominating that market, AT&T. By most reasonable revenue estimates, in 1984 AT&T possessed roughly 90 percent of the existing market (and 94 percent of all call minutes), compared to its competitors' combined share of about 10 percent. Its corporate assets, even after divestiture, total almost \$40 billion, compared to its three largest rivals' total of less than \$6 billion. AT&T has approximately 120,000 employees; its three largest rivals have a combined total of about 16,000. Most significantly, however, its financial position is solid and improving. In the first quarter of 1985, AT&T had \$354 million in earnings. On the other hand, GTE Sprint lost \$68 million in the second quarter of 1985; its profits sank from \$82 million in 1983 to \$67 million in 1984. Satellite Business Systems (SBS), originally a joint venture by COMSAT, Aetna Life and Casualty, and IBM, has sustained such large and continuing losses¹² that all of the original joint venturers have withdrawn and SBS has been acquired by MCI. MCI, whose 1984 profits dropped almost 40 percent below its 1983 profits, has in turn been partially acquired by IBM, a development conceded to indicate that MCI needs extensive cash infusion to compete with AT&T.¹³ Last year US Telecom lost over \$68 million, and in the first half of this year the company lost \$33.9 million.¹⁴

Given the vital importance of independent transmission networks to the establishment of workable competition in the long distance market, it is appropriate to focus specifically on the comparative costs of network acquisition. AT&T has had over fifty years to accumulate its fourteen billion dollar investment in network facilities; by contrast, US Telecom will have less than five years to accumulate a \$2 billion plus

¹¹ A map illustrating the U.S. Telecom network by year-end 1985 and at its completion in 1988 appears as Appendix D.

¹² SBS posted losses of more than \$120 million for each of its first three years of operation (1981-1984), and was not expected to show a profit until 1987 at the earliest. SBS had laid off about 14 percent of its employees last year. IBM is assuming SBS' over \$400,000 in outstanding debt and will buy out Aetna's remaining interest prior to SBS' transfer to MCI.

¹³ IBM has acquired approximately 16 percent of MCI and may acquire up to 30 percent without further authorization from MCI. IBM's purchase is viewed as but the first step in a staged acquisition of MCI by IBM. See generally, "MCI Gets Big Lift from IBM," *New York Times*, June 26, 1985; "IBM Agrees to Buy 16% of MCI As Part of Far-Reaching Accord," *Wall Street Journal*, June 26, 1985. Although the IBM-MCI transaction has been cited by AT&T for the proposition that the interexchange market is robustly competitive and that Commission regulation of AT&T can summarily be jettisoned, Chairman McGowan of MCI succinctly demolished the notion that the merger represented a big leap into the market by IBM. "The day before we made the announcement, IBM had 60 percent control of a long distance carrier. The day after, they had 16 percent control." *Computerworld*, July 15, 1985, p. 5.

¹⁴ From this perspective it is somewhat ironic that the recent over-subscription of United Telecom stock is cited by AT&T as proof that competition in the interexchange market is healthy. We attribute the oversubscription to the fact that United Telecom stock has historically been a reliable dividend payer, rather than to a groundswell of mass confidence in the vitality of competition in the interexchange market.

investment in our network. With its network paid for and in place, AT&T will enjoy a decrease in its costs as its competitors' costs increase, as a consequence of the FCC's access charge decisions.¹⁵ AT&T total costs per call minute will successively decrease over the next years. By comparison, US Telecom's current access costs will increase as a result of the conversion to equal access and the implementation of EGD rates. U.S. Telecom predicts that the cumulative effect of the FCC's decisions will be to increase our costs by over \$900 million in the five years.¹⁶

CURRENT STATE OF REGULATION OF THE LONG-DISTANCE MARKET

Having clarified the factual context of the long distance industry, it is now appropriate to examine its regulatory context.

Regulatory Issues

Although the competitive carriers provided the key to maximizing long-term consumer welfare in the provision of long distance services, they also spawned a set of pressing regulatory problems that demanded resolution. The most immediate of these was the establishment of the price that competitive carriers ought to pay local exchange companies for the substantially inferior interconnection arrangements the competitive carriers received in comparison to AT&T. After considerable contention, the parties established a nonpremium price for OCC interconnections that reflected a rough approximation of the lesser value these inferior interconnections had.¹⁷ The second problem was how to restructure the entire system of intra-industry payments long distance carriers paid to local carriers for access in order to reflect the advent of competition in both public switched as well as private line service. Finally, because competition in the interexchange market can replace the need for extrinsic federal regulation of AT&T, the Commission needed to determine what degree of continued regulation of AT&T would be appropriate as competition continued its evolution. The Commission attempted to solve the second problem by adopting its revised access charge rules¹⁸ and it instituted proceedings to examine the myriad of complex issues involved in determining to what extent AT&T should remain regulated in the short and long terms.¹⁹

The Modification of Final Judgment

In 1982 the United States and AT&T reached an agreement to settle the government's antitrust suit against AT&T. The entry of the MFJ²⁰ proved to be a watershed event in its effect on the Commission's analysis of the regulatory issues outlined above. The MFJ and the Commission's regulatory policies shared the same public interest predicate of enhancing competition in the interexchange market.²¹ Because of the way the issues were cast, however, the Court's antitrust focus centered on only one of the two sources of AT&T's facilities dominance: its ownership of the local Bell Operating Companies (BOCs). From the court's perspective, "the principal means by which AT&T has maintained monopoly power in telecommunications has been its control of the Operating Companies with their strategic bottleneck position."²² Thus, the Court found that divestiture of the BOCs would enhance competition and eliminate AT&T's opportunity to engage in anticompetitive conduct by providing discriminatory interconnection and by cross-subsidizing and cost-shifting between its competitive interexchange and monopoly local services.²³

¹⁵ *Third Report and Order in CC Docket No. 78-72*, 48 Fed. Reg. 10319 (March 11, 1983); MEMORANDUM OPINION AND ORDER IN CC DOCKET NO. 78-72, 48 Fed. Reg. 42984 (September 21, 1983).

¹⁶ The derivation of this figure is presented as Appendix E. The NTIA Report recognized that "The competitive carriers do face something of an undesirable 'time-wrap' problem as higher access charges, the costs of building their network, AT&T price reductions, and imperfections in the 'equal access' process all collide." *Id.* at 96.

¹⁷ *ENFIA*, 71 FCC2d 440 (1978).

¹⁸ See *MTS and WATS Market Structure*, 97 FCC2d 834, 854 (1984); *MTS and WATS Market Structure*, 97 FCC2d 682, 726-28 (1983); *AT&T*, 91 FCC2d 1079, 1083 (1982).

¹⁹ *Notice of Inquiry in CC Docket No. 83-1147*, 95 FCC2d 510 (1983).

²⁰ The Modification of Final Judgment constitutes the opinion of the court in *United States v. American Telephone and Telegraph Company*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983).

²¹ "A central purpose of the AT&T antitrust litigation and subsequent divestiture was to ensure and reinforce the availability of customer choices." *NTIA Report* at 86.

²² 552 F. Supp. at 171.

²³ *Id.* at 172.

To assure that the divestiture would in fact provide technically equal interconnection arrangements to the competitive carriers, the Court imposed on the local carriers the obligation to provide interconnections "equal in type, quality, and price" to those they provided to AT&T. The Court stated that this requirement "will effectively remove any interconnection-type obstacles to free competition between AT&T and the other carriers" and therefore it "comports with the public interest . . ." ²⁴ In the interests of minimizing the burden of compliance to be borne by the local carriers, ²⁵ the Court permitted a three-year phase-in period, ²⁶ exempted some local exchange companies completely, ²⁷ and left the manner of achieving compliance up to the local companies. ²⁸

The MFJ and the Larger Issue of Developing Competition.

The divestiture Court appropriately focused solely on the antitrust issues before it, and resolved them in the most direct manner consistent with avoiding the imposition of unduly onerous burdens on the local exchange carriers. The Court's focus was not, and indeed could not properly have been, on the larger issue of how its mandate affected the overall workings of the Commission's competitive policies, or what prophylactic response the Commission should make to its policies to accommodate the MFJ in a manner compatible with the shared objective of creating a truly competitive environment in the long distance industry. ²⁹

Indeed, the MFJ shows clearly that the Court's opinion was not intended to be a definitive articulation of the regulatory decisions that would serve the public interest. For example, in stating its belief that divestiture would encourage competition by imposing a structurally-based inhibition to anticompetitive behavior, the Court was careful to note that, "To the extent AT&T still has some potential for engaging in anticompetitive behavior, there is of course nothing in the proposed decree to immunize it from its obligations under the regulatory decisions . . ." ³⁰ Similarly, on the critical issue of what price competitive carriers should be required to pay for access, the Court noted that, "If there is no difference in the cost of providing [access] services, it would be appropriate for charges to AT&T to be increased to reflect its higher quality connection. *The Court will not impose this requirement because it lacks the expertise and flexibility to determine the amount of such a premium, but regulators remain free to insist on such a differential . . .* [In this way] the Court will not have to place a monetary value on the lower quality service." ³¹

Finally, in denying a request by the FCC that the court specifically condition the MFJ by a clause preserving the FCC's jurisdiction in the event of a conflict with the decree, the Court quoted approvingly from the FCC's own brief in stating, "The addition of such a provision would not change the substance of the proposed [decree]. There is no reason to suppose that either party to the settlement ever intended to affect any Commission power. Moreover, the failure to add such a proviso would not expand the court's power or contract the Commission's power." ³²

The FMJ's Impact on the Commission's Transition Policies

Notwithstanding the fact that the MFJ was clearly not intended to circumscribe the FCC's discretion to deal with the broader public policy issues involved, the Commission simply incorporated the principal features of the equal access plan as its own blueprint for defining and attaining regulatory parity between AT&T and the competitive interexchange carriers. Pursuant to this schedule competitive carriers are required to pay full premium access rates for Feature Group D interconnection on an end office-by-end office basis as individual end offices are converted, with the result that functional parity has been equated with economic parity. Parity is thus achieved, in the FCC's view, as of September 1, 1986, the MFJ's deadline for equal access conversion.

²⁴ *Id.* at 196.

²⁵ *Id.* at 197.

²⁶ *Id.* at 196.

²⁷ *Id.* at 233.

²⁸ *Id.* at 196.

²⁹ Compare MFJ at 188 "... the very purpose of the decree [is] to create a truly competitive environment in the telecommunications industry," and the *Report and Third Supplemental Notice of Inquiry and Proposed Rulemaking in CC Docket No 78-72*, *supra* at n. 6, at 203: "Our decision here, declaring MTS-WATS competition to be in the public interest, is simply a further (perhaps the last) step in our efforts to remove entry barriers and insure the benefits of competition in the provision of telecommunications service."

³⁰ 522 F. Supp. at 172, n. 176.

³¹ *Id.* at 199, nn. 287-8, emphasis added.

³² *Id.* at 212, quoting from brief of FCC as *amicus curiae* at 27-28, emphasis added.

competition in the long distance market in equating Feature Group D technological access with competitive or economic parity. Even worse, the harm the FCC's current regulatory policies are causing competitive carriers is magnified by the FCC's apparent intent to simultaneously deregulate AT&T in a piecemeal fashion through the current tariff review process.

The NTIA Report finds specifically that, "The public has borne costs as a consequence of divestiture. Maintaining reasonable choices is thus important as an equitable proposition, as well as a matter of practical politics." *Id.* at 87. The FCC's policies governing the critical period of transitioning from monopoly to competition undercut the maintenance of competition, and therefore harm the public's strong equitable interest in consumer choice from among a number of viable long-distance communications providers.

USE OF THE TARIFF PROCESS TO DEREGULATE AT&T

The Critical Nature of Costs

As discussed previously, costs are critical to competitive carriers at this stage of the industry's development for two reasons. First, the continuing need to rely on AT&T's long distance transmission facilities narrows the scope of competition between AT&T and the newer interexchange carriers to price. Second, those competitors, like US Telecom, that are now in the process of securing their own separate transmission facilities are sustaining huge losses to do so, and are thus particularly vulnerable to AT&T's underpricing its services. The NTIA Report recognizes these realities, stating that, "The competitive carriers, in short, are being squeezed at both ends."³³

Thus, it is now more important than ever that the Commission continue for the time being the current safeguards contained in its tariff review process that assure that AT&T's services are priced fairly and not below cost. And yet the Commission has picked precisely this time to signal its intent to abandon these current policies in favor of cost justification methodologies that allow AT&T to price its new services below cost.

AT&T has lost no time taking advantage of the Commission's new attitude towards pricing below cost. AT&T's PRO-America tariff,³⁴ presented as an "optional" MTS service prompted by the need to respond to competition, would by AT&T's own admission not recover costs until 1986. It is aimed squarely at the small business users who form an important segment of competitive carrier's business. AT&T's proposed SDNS tariff, submitted in response to virtual private network services such as those just beginning to be provided by US Telecom, contained no cost justification for rates of SDNS being lower than rates for apparently comparable MTS, WATS and private line services, no cost justification for large nonrecurring charge, and no substantiation for AT&T's estimate of access costs.³⁵ AT&T's recent Megacom tariff,³⁶ aimed at high volume WATS users, projects an unjustifiably large demand for the service which, even if accurate, would fail to generate sufficient revenues to cover the costs of providing the service.

Although these tariffs have not yet gone into effect,³⁷ there is every reason to believe that the current trend toward deregulating AT&T through the tariff process

³³ NTIA Report at 98.

³⁴ *In the Matter of AT&T Communications*, Tariff FCC No. 1 (Transmittal No. 301), FCC 85-223, released May 2, 1985.

³⁵ *In the Matter of AT&T Communications*, Tariff FCC Nos. 1, 9, and 10, (Transmittal No. 321), March 6, 1985.

³⁶ *In the Matter of AT&T Communications*, Tariff FCC Nos. 1, 9, and 10, (Transmittal No. 439), July 31, 1985.

³⁷ Both the PRO-America and SDNS tariff have been suspended pending the submission of further information by AT&T. However, both the Common Carrier Bureau in the SDNS *Suspension Order* and the Commission in its *Order* on AT&T's withdrawn Accunet tariff have indicated that SDN and Accunet services may be offered to customers on an untariffed basis. See *In the Matter of AT&T Communications*, Tariff FCC Nos. 1, 4, and 10, Transmittal No. 321, Mimeo No. 5282, CC Docket No. 85-203, released June 20, 1985, 11 at n. 17; *In the Matter of AT&T Communications*, Tariff FCC Nos. 260, 266, 267, 268, 270 and 274, Transmittal No. 148, CC Docket No. 84-906, adopted June 21 1985. In the interim the Common Carrier Bureau has allowed AT&T to offer SDNS to a customer on an untariffed basis notwithstanding the tariff's suspension. Letter from Albert Halprin to Thomas J. Berry, Jr., Mimeo No. 6230, released August 6, 1985.

something that the Commission seems inclined to do.

At this point it is necessary to emphasize that US Telecom does not oppose the FCC extending to AT&T relief that lifts overburdensome procedural requirements as long as the substance of the Commission's rules remains intact. Nor is it necessary here to defend the proposition that the fully distributed cost methodology currently used by the FCC is appropriate for us in all rate-setting contexts. However, after extensive proceedings in which various costing methodologies were considered, in 1976 the Commission adopted the fully-distributed cost methodology because it furthers resource expansion and economic development.³⁸ Moreover, the FCC recognized at that time that the very marginal cost pricing policy that it now wants to apply is unsuitable for tariff review purposes because its cost allocations simply cannot be verified.

Finally, it is important to note that the NTIA Report comes down squarely against the FCC's new liberalized cost justification policy. The Report unequivocally states that, "Prior to the completion of the equal access process . . . we believe the FCC should continue to exercise close scrutiny of any proposed major rate reduction by the dominant firm."³⁹

THE FCC'S VIEW OF MARKET CONTESTABILITY

The reason why the FCC's continued pursuit of these revisionist tariff policies will seriously damage competition is that they are byproducts of the FCC's erroneous perception of the state of competition in the long distance market. The Commission's current approach seems premised in large measure on the assumption that the large number of resellers proves that the interexchange market is, if not workably competitive, at least contestable, and that market contestability will, in theory, constraint AT&T to align its prices with costs out of fear that if it does not competitors will take advantage of the Commission's free entry and resale policies to offer lower rates.

The market contestability theory is simple, a persuasive, and completely inapplicable to the long distance market. A complete technical explanation of why this is so is provided by U.S. Telecom's in-house telecommunications economic analyst at Appendix F. In layman's terms, however, it boils down to the fact that, when it comes to the interexchange market, the raw number of competitors means relatively little, because they still largely rely on AT&T's network facilities to provide competing service. Thus, although hundreds of competitors may keep AT&T from raising its prices, they can do nothing to keep AT&T from raising its prices, they can do nothing to keep AT&T from lowering its prices and driving them out of the market. Only the Commission can keep AT&T from doing that. But by its new policies permitting AT&T to set prices below cost, the Commission is unthinkingly helping AT&T to pursue this very strategy.

The Issue of Short-Term Benefits versus Long-Term Benefits

When the theory of contestability fails the Commission must confront the reality of, and deal responsibly with the public policy implications of, an AT&T that overwhelmingly dominates the interexchange market. The Commission must also factor into its analysis the added advantages AT&T drives from the economies of scale it enjoys and from its identification by consumers as the institutional provider of long distance transmission service—both of which accrued to AT&T over a fifty-year period during which it enjoyed a government-endorsed market monopoly.

The crux of the current problem is which regulatory result ultimately serves the public interest better: long term resource expansion or short term expediency. The impetus behind the FCC's current deregulatory initiatives appears to be the desire to achieve the short term benefits that accrue to consumers from more efficient use of AT&T's existing network, as opposed to the long-term benefits of new and better products at lower cost that workable competition is uniquely suited to produce.

U.S. Telecom vigorously disagrees with the public policy choice the Commission is making. As a first principle, we believe it incumbent upon the FCC to recognize, as it apparently did in the now-abandoned Docket 83-1147, that any action measurably

³⁸ *Report and Order in Docket No. 18128*, 61 FCC 2d 587 (1976), *aff'd sub nom. ARINC v. FCC*, 642 F2d 1221 (1980).

³⁹ *NTIA Report* at 98. NTIA would have the FCC maintain close cost-justification scrutiny until September 1985, when "equal access" will supposedly have been implemented. US Telecom disagrees with the factual predicate for the establishment of September 1986 as the appropriate date. See pp. 20-25, *infra*.

deregulating AT&T has long term as well as short term effects. In the interests of rational decisionmaking, the FCC must, in an appropriate Commission Order, articulate fully its views of what social welfare criterion—and therefore what type of regulation—best serves the ultimate interests of the American public. The Commission must then thoughtfully and comprehensively revise its current regulatory program to the extent necessary to realize its social welfare views. This meant that the Commission should adhere to consistent and established cost standards and tariff structures to meet an objective of long-term public benefit. U.S. Telecom believes that trial and error decisionmaking is totally inappropriate for a successful and orderly transition from monopoly and regulation to competition and deregulation.

A truly competitive telecommunications market has the unquestioned advantage of promoting the development of new and better services at lower prices than a monopoly or duopoly market. Thus, US Telecom believes that the FCC should devote its energies to bringing about a truly competitive market structure as opposed to optimizing the more efficient working of the existing AT&T network. This involves the adoption and pursuit of pro-competitive regulatory policies whose prime objective is to eliminate the unquestioned market dominance of AT&T and counterbalance the incomparable advantages AT&T currently enjoys as the sole, institutional provider of long distance communications services for over fifty years.

By grounding its noncost-based revisionary tariff proposals in large part on the desirable effects of stimulating the existing network's efficiency and allowing total MTS revenues to increase, the Commission is choosing to pursue the static, short term efficiencies in the existing network over the dynamic, long term consumer benefits it has consistently stated that competition would produce by bringing about innovative services, superior quality, an expanding resource base, and continued economic development. Meaningful competition can only occur, however, when AT&T's competitors can control their own costs rather than having them controlled by AT&T. This, in turn, can only occur when independent transmission networks break the current need of AT&T's competitors to depend on AT&T's network. As we have shown, the industry has developed to the point at which these critically-important networks are being built. But this development is dangerously close to being lost in the fact of regulatory policies that disregard the realities of the market.

**THE COMMISSION'S CURRENT TRANSITION PLAN IS ANTITHETICAL TO COMPETITION AND
MUST BE REVISED**

Perhaps the best place to start conforming the FCC's policies to reality and reforming them to encourage developing competition is in the FCC's current equal access conversion process. As noted previously, the Commission has decided to adopt not only the MFJ's definition of equal access but also the MFJ's phase-in schedule as the parameters of its own plan for the transition to general parity between AT&T and the competitive carriers. US Telecom maintains that this approach ignores the fact that even after conversion to equal access the value to OCCs of that access will not be commensurate with its value to AT&T. Moreover, we further believe that difficulties inuring in the conversion process, although not cognizable under the MFJ, demand the Commission's careful attention as matters affecting national telecommunications policy because of their collective impact on the development of competition in the interexchange market. Because recent statements by senior FCC staff strongly suggest that we will not get a fair hearing on these issues from the Commission, US Telecom brings them to your attention today.

Competitive carriers derive substantially less value from FGD access than AT&T and should be charged less for it.—First and foremost, US Telecom believes that Feature Group D is not equal access because of the obvious disparity in the use value of Feature Group D between AT&T and its competitors. The MFJ did not purport to establish that the provision of technical equal access would be the talisman to immediately make the smaller interexchange carriers equal to AT&T in terms of the services they could provide by using it. Indeed, the court stated simply that its "broad guarantee of equal treatment, when implemented, will effectively remove any interconnection-type obstacles to free competition between AT&T and the other carriers . . ." ⁴⁰ The court's concern in the divestiture proceeding was to dissolve the physical bottleneck that the AT&T-owned BOCs had interposed against the competitive carriers. The court was appropriately not concerned about the larger issue of any competitive disparity that would remain notwithstanding technical equal access, nor the accurate use valuation of that access to AT&T and its competitors.

⁴⁰ 552 F. Supp. at 196.

But the Commission is responsible for these larger policy issues, and by simply adopting the MFJ's definition of equal access and the MFJ's phase-in schedule the Commission has avoided its responsibility. This avoidance and its results, described in detail below, also prompts US Telecom's appearance today.

Economic use value versus technical quality of FGD access.—The key fact ignored by the FCC is that, although AT&T's competitors arguably receive the same technical quality as AT&T when they purchase FGD access, they do not receive anything approaching the same economic quality. First, AT&T enjoys FGD access or its equivalent everywhere, whereas other interexchange carriers receive it only in converted end offices.⁴¹ FGD access provides dialing arrangement advantages over the inferior access modes, as well as higher transmission quality in terms of clarity and signal loss. These technical advantages translate into economic value because of their higher use values. Thus, AT&T has high use values from its enjoyment of FGD access throughout its entire network, although its competitors obtain only a portion of these values in selected geographic areas.

One ready example of how AT&T derives higher economic value from its superior access arrangements is its exclusive opportunity to introduce and market new services on a system-wide basis. The uniformity of access services over AT&T's entire service territory provides it with economies for each of its advertising dollars. These economies do not accrue to its competitors, because they must introduce and market their services on an end office by end office basis. These geographic restrictions, combined with resultant customer confusion, severely dilute the effectiveness of the competitive carriers' advertising dollars. A similar reduction in the effectiveness of OCC advertising dollars occurs in marketing our current services. In order for US Telecom to take immediate advantage of conversions to technical equal access, we must notify existing and potential customers of our expanded technical capabilities on an end office by end office basis. The start up cost component of each of our advertising campaigns therefore increases the average cost of our advertising, and this reduces its economic value vis-a-vis AT&T's advertising.⁴² These realities need to be recognized in the pricing of FGD access.

Piecemeal equal access conversions have negatively affected the use value of FGD access as well. For example, OCCs do not derive the technical benefits of FGD access unless both the end office originating a call and the end office terminating a call are cut over the FGD. Notwithstanding this fact, under the Commission's transition plan OCCs must pay the full FGD rate for calls terminating at a FGD end office even though the originating office may offer only FGA service, and consequently the call lacks answer supervision service, automatic number identification and dialing parity, as well as provides inferior technical quality. This incompatibility in access features between originating and terminating end offices also affects the use of OCC services with credit cards or while travelling, both of which are important to the business customers who are vital to interexchange carrier revenues. As a result, the equal access conversion must be virtually complete nationwide before competitive carriers derive the full benefits of FGD.

Different economic use values for FGD access should be reflected in different prices for FGD access.—There are economically sound ways of reflecting these different use values of technically equal access; in fact, the Commission's nonpremium access charge plan was based upon them. The economic rationale of the equal access debate has rested on the fact that AT&T's historic association with the local exchange carriers has provided it with nationwide, uniform access that is highly valued by both AT&T and the other interexchange carriers. This fact forms the premise for the conclusion that all interexchange carriers should pay an equal price for equal access. Using equal price for equal access as the second premise, the Commission reached the important conclusion that access values should reflect the differences in use values between AT&T and the other interexchange carriers. Conse-

⁴¹ Many end offices, of course, remain unconverted and will never be converted to Feature Group D. For example, New York Telephone estimates that, by the MFJ final deadline, only 50 percent of its main stations will be converted, including parts of New York City. Pacific Telephone has indicated that 25 percent of its end offices will be unconverted past September 1986. A total of over 20 percent of all telephones in the country will not be connected to FGD end offices by September 1986. GTE Sprint *Motion to Enlarge Issues*, filed in CC Docket No. 83-1145, Phase I, at pp. 26, 29.

⁴² Specifically, the seriatim conversion of end offices forces competitive carriers to forego mass media advertising in favor of more costly direct or concurrent mail campaigns. A comparison of mass media and direct mail costs for three cities, Chicago, Baltimore, and Memphis, shows that phased direct mail is 77.6 percent, 62.9 percent, and 85.8 percent more expensive than television advertising in these respective cities. The derivation of these figures is set out at Appendix G.

quently, technically inferior access was priced below AT&T's technically superior access.

In its brief on appeal of the access charge decision, the Commission acknowledged that, "Because there is no purely economic method of determining the [FGD] premium, the Commission may take into account other factors, such as elements of fairness and other noneconomic values."⁴³

US Telecom believes that the same principles apply in pricing the comparative use values of FGD access to AT&T and to the competitive interexchange carriers. Based on our preceding description of the current telecommunication environment, US Telecom concludes that it will be several years at least before the technical equal access available to interexchange carriers other than AT&T will approach the use value of AT&T's nationwide, uniform access arrangement. Customers within equal access areas want the same voice clarity and bit stream loss levels no matter where they terminate. Credit card users want dialing arrangements that minimize the number of digits no matter where they are originating. Our advertising dollars must not only educate consumers that technical equal access is available, but also overcome their habit of using AT&T as their long distance carrier.⁴⁴ To accomplish this, other interexchange carriers must be able to use or market their technical equal access advantages at a given end office or tandem with the same effectiveness as AT&T uses, advertises and markets the advantages of its nationwide, uniform equal access.

It is not US Telecom's purpose in these hearings to extensively argue the precise correct valuation of the economic use value differential of FGD access. We respectfully submit, however, that a case has been amply made to require that the Commission immediately (1) stay the current requirement that the competitive interexchange carriers begin paying full premium access rates upon individual end office conversion, (2) conduct expedited proceedings to determine the actual value of FGD access to competitive interexchange carriers, as compared to AT&T's arrangements, and to further determine (a) the current fair market value of FGD; and (b) whether, and to what extent, the value of FGD access to interexchange carriers will change in the future.

Other advantages enjoyed solely by AT&T exaggerate the disparity in FGD use value and must be taken into account in pricing FGD access.—There are certain other services which only AT&T, and not the competitive interexchange carriers, can offer. Although the inability to offer these services does not necessarily hinge on the provision of technical equal access, their unavailability to the competitive carriers unquestionably affects the economic value to them of FGD interconnection.

Notwithstanding the presence of an active reseller submarket nor the entering of the MFJ, AT&T retains a monopoly over certain services. These include international telephone service (IMTS), 800 service, 900 service, coin sent paid and automated credit card service. These are enjoyed by AT&T in many cases as a result of the national numbering plan (that was designed by and exclusively for AT&T), sophisticated operating and data systems developed at public ratepayers' expense, and the unique capability of the BOC switches designed to assist AT&T's services but not available to AT&T's competitors. It will take local carriers years of effort and it will cost millions of dollars to provide interexchange carriers with competitive 800 service. Thus, even after equal access is phased in, AT&T will remain the only full service long distance carrier if it is permitted to retain exclusive rights to this technology.

US Telecom believes that fair valuation of the economic use value of FGD access must reflect the competitive interexchange carriers' inability to utilize it to the same extent as AT&T to provide the enumerated services. Therefore, US Telecom believes that the current misvaluation must be cured by reflecting their unavailability in future appropriate devaluation of the premium access charge.

Similarly, AT&T derives higher use value from FGD access by virtue of the multiple points of presence (POPs) it enjoys in each LATA. Like the advanced systems discussed above, these multiple POPs were largely acquired at the expense of monopoly ratepayers, and they enable AT&T to minimize the transport charges accruing from distance-sensitive FGD rates by putting AT&T in physical proximity to end offices. By contrast, competing carriers, with their enormous construction costs, can typically establish but a single facilities POP in most LATAs. Thus, the higher use value AT&T derives from FGD by virtue of the embedded advantages of its multiple

⁴³ *NARUC v. FCC*, brief of appellee FCC at 72 (citation omitted).

⁴⁴ The divestiture court observed that, "as more competitors begin to offer more services that are comparable to those offered by AT&T, entrenched customer preferences in favor AT&T will decrease." 552 F. Supp. at 172, (footnote omitted), emphasis added.

POPs' minimization of transport costs should also be reflected in appropriate devaluing of the FGD rates paid by other interexchange carriers.

Other unforeseen problems in equal access implementation are affecting competition in the interexchange market and demand immediate action.—The MFJ deferred to the expertise and resource limitations of the local exchange companies to develop the actual plan for equal access conversions within the overall phased time schedule the court established. This action, taken in the interests of minimizing the compliance costs imposed on the BOCs, was perfectly reasonable from the perspective of the divestiture court. However, the Commission has much broader policymaking responsibilities under the Communications Act, including the responsibility of weighing into the public interest balance the effects the MFJ's plan will produce on the development of interexchange competition. From this perspective, the Commission's adoption of the MFJ's plan fails to reflect a thorough analysis of the many interests involved. The Commission's current plan reflects only the assumption that the interests of the affected local exchange carriers in implementing FGD as quickly as possible perfectly coincide with the interests of the affected interexchange carriers and the larger public interest in interexchange competition. The Commission has avoided confronting these overarching public policy issues, and has instead left it to the former Bell Operating Companies to decide them. Not at all surprisingly, this has produced a number of problems that aggravate the already critical difficulties that competitive interexchange carriers face during the transition from demonopolization to competition. The negative effect of these problems on the development of competition in the interexchange market demand relief.

Lack of Tandem Switches

The haphazard cutover of individual end offices to technical equal access has spawned a host of problems for competitive interexchange carriers. One of the chronic difficulties in this area has been the absence of tandem switches.

Although the MFJ envisioned the widespread use of tandem switches to avoid the need for interexchange carriers to provide direct trunk connections to each individual end office, this has not occurred. Typically, the installation of tandem switches has been spotty and delayed, and has resulted in the competitive interexchange carriers having to access local exchange carriers through individual end office connections. This in turn imposes heavy added costs on OCCs in several different ways. First, the absence of tandems forces OCCs to forecast traffic on an end office by end office basis. Lacking the extensive historical traffic data available to AT&T, OCCs can only approximate this traffic, and to avoid customer dissatisfaction from inadequate line capacity they typically overorder. This ultimately becomes stranded investment when tandems finally are installed.

Using Dallas, Texas as a model and assuming full equal access, US Telecom compared the cost of using one- and two-way trunks to each end office with using an access tandem. When Dallas was examined as a switch city, the cost of using one-way trunks was over a quarter million dollars a year above the cost of using an access tandem while the cost of using two-way trunks was nearly \$200,000 above the cost of using a tandem. These figures reflect the impact on Dallas alone; a like impact may be projected in other US Telecom switch cities.

The cost disparity was more pronounced when Dallas was modeled as a distant city; that is, a city whose traffic is backhauled to a switch city, because of the transport charges involved. In this comparison the cost of a one-way trunk system was \$1,750,000 per year above the cost of a tandem system while a two-way trunk system showed a cost increase of \$1,100,000 per year. Again these figures are for the Dallas model above; each city can expect a similar cost increase. They do not include the costs of maintaining the greater number of trunk groups which non-tandem equal access requires. For Dallas, non-tandem equal access would require 59 one-way or 31 two-way trunk groups, while only 4 trunk groups would be required with an access tandem.

US Telecom has had to order direct trunks due to the absence of FGD tandems in New York, Detroit, Philadelphia, Washington, D.C., Oakland, Minneapolis, Omaha, Denver, Baltimore, Salt Lake City, Tucson, Oklahoma City, Tulsa, El Paso, San Antonio, and Fort Worth. This listing, it should be noted, is not all-inclusive; it simply denotes major locations and is offered to illustrate the pervasiveness of the problem.

Lack of Data on Traffic Patterns

Exacerbating the problem of ordering direct trunk facilities is the chronic problem competitive carriers confront in estimating the facilities they will actually need. Only AT&T possesses the historic traffic data and detailed customer information that makes accurate traffic forecasting possible. Without this information, competi-

tive carriers cannot determine with any precision the number of circuits they will ultimately need, and are forced to overorder (and, therefore, overpay) to provide some assurance of adequate capacity.

As US Telecom demonstrated previously, a high capital outlay is required to enter the interexchange market. To the extent additional funds go toward the procurement of estimated intraLATA circuits that may not be needed, they constitute special costs that AT&T does not now bear and that accordingly add to the difficulty in transiting the interexchange market to meaningful competition. The interests of developing competition are disserved to the extent the Commission ignores minimally intrusive means of lessening these costs. Therefore, US Telecom believes that the Commission must, at a minimum, permit competitive interexchange carriers appropriate access to the historic traffic data possessed by AT&T.

Facilities Provisioning and Access Billing Problems

Another source of added expense for interexchange carriers is the myriad of problems generally grouped under the heading of provisioning problems. These involve the business problems caused by facilities delays and failure to receive facilities at all, and their cumulative impact is startling.

US Telecom's Universal TravelCard (credit card) service illustrates the impact of the circuit provisioning problem. US Telecom announced this service in February, 1984 and in March ordered the necessary 800 circuits. These had a target installation date of May 4. By May 4, US Telecom was backordered on 500 circuits, some of which were as far as six months in arrears, with no firm delivery date. In July, US Telecom finally received an installation date of August 1, and in September we started marketing the Universal TravelCard Feature. Five months later, however, US Telecom was forced to cease actively marketing TravelCard due to the continuing lack of sufficient 800 circuits. At this time over 50 percent of the 126 circuits then on order had been ordered more than two months previously. It is estimated that, had the necessary circuits been available on schedule over 6,500 TravelCard customers per month might have been served. As of May 15, this represents a loss of over 19,000 TravelCard customers, 2,000,000 call minutes, and almost \$800,000 in revenue. Of this total loss, approximately 85 percent would represent lost revenue.

The NTIA Report states that, "In addition to closely scrutinizing any proposed rate reductions by the dominant long-distance carrier until the completion of the "equal access" process, we believe the FCC should address what appear to be persistent and unwarranted service problems affecting certain parts of the long-distance business . . .

"In an era of increasing automation a computer-operated telecommunications network, there would seem to be little good reason for the unwarranted delays business and other customers have experienced in securing certain telephone services. These delays evidently are due to the inability or unwillingness of the constituent parts of the former Bell System to interact effectively and smoothly. The FCC appropriately has instructed the Bell Operating Companies and AT&T to improve their service to the public. Efforts in this regard by both industry and Government, however, should be redoubled."⁴⁵

THE NEED FOR CONGRESSIONAL INTERVENTION

These costs are not enumerated for the purpose of requesting some form of relief that will provide dollar-for-dollar compensation. Indeed, for at least some of these problems no regulatory remedy arguably exists. To some extent they may more appropriately be addressed by an antitrust court, if deliberately imposed, or they otherwise may be characterized as costs of doing business associated in what is admittedly a difficult market at a difficult point in its evolution.

Rather, US Telecom raises these difficulties to show that, in certain contexts, what appear to be nominally proprietary interests can and do have unavoidable public policy implications. The demonopolization of AT&T and the simultaneous transition to technical equal access is most assuredly one of those contexts. At this juncture in the development of interexchange competition, AT&T's fledgling competitors are incurring billions of dollars in network construction costs and added millions in FGD access costs while AT&T, abetted by the Commission's proposed "tariff review guidelines," is selectively attempting to drop its prices below its costs. Against this backdrop of an already difficult cost-price squeeze, the added costs imposed by the Commission's use of the MFJ cutover plan disproportionately exacerbate the competitive problems the new interexchange carriers face.

⁴⁵ NTIA Report *supra* at 98-9.

Because there is no competition without competitors, the failure of the Commission to address issues so immediately affecting the viability of the competitive interexchange industry is in direct derogation of the Commission's responsibilities under the Communications Act.

CONCLUSION

The *NTIA Report* recognizes that, "... The implementation of "equal access" has proven more complicated than was originally predicted by nearly all parties involved. ... Not all of the gains which the competitive carriers may have expected as a consequence of this step have yet materialized. AT&T has also proven a formidable and effective competitor.

"It is important to bear in mind that we are in the midst of a complicated and difficult transition, away from a market characterized by "sole source" provision of a basic service toward a much more competitive environment. Sound public policy dictates that any transition from pervasively regulated monopoly toward regulated competition be as fair as possible. Firm failure as a consequence of management errors, miscalculations, inadequate marketing or other measures, while it is obviously undesirable to those immediately involved, is quite different in effect than failure caused by inflexible Government policy. Both the perception and the reality of fairness matters, as each has a bearing on capital costs and the likelihood of future competitive entry. If an industry is perceived as laboring under unfair or unpredictable rules, capital is likely to be available only at a premium commensurate with such risks. Ensuring fairness and reasonable predictability to the maximum extent possible, therefore, should be an important Government goal."⁴⁶

Thus, the issue is not whether new market entrants like US Telecom will incur losses during their start-up years. This, we agree, is an unavoidable result of entry into many markets. Rational entry presupposes that the firm recognized the likelihood of early losses, and was willing to trade these off for future profits. Furthermore, rational entry does not presuppose that the Commission will intervene to make all investments profitable in the long run.

However, rational entry into a regulated market does presuppose that public policy changes will not abort long term profitability because policymakers failed to competently evaluate the expected outcomes of their decisions. It does not follow, as has been suggested, that having agreed to accept the reasonably foreseeable risks and losses of entering the market, competitive carriers must also be expected to accept huge unforeseeable losses that result from regulatory decisions by the Commission.

The truly unique obstacles any company, regardless of size, faces in attempting to compete with AT&T places a correspondingly unique responsibility on the Commission to exercise particular care in crafting its regulatory policies in order to avoid gratuitously exacerbating the foreseeable difficulties with entirely new and unforeseeable difficulties. By its failure to rationally analyze the many-faceted issues presented by a matter as important, as enormous, and as unprecedented as the deregulation of AT&T, the Commission is coming dangerously close to depriving the American people of the benefits of competition that the divestiture and ten years of patient effort by prior Commissions have sought to achieve.

Deregulation is a means, not an end. It is the responsibility of government to define when and how a monopoly provider is to be deregulated so that competitors, and the consuming public, can react and plan for the future. Implicit in this process is the realization that not all markets are identical, and that their distinguishing characteristics must be accounted for if deregulation is to be effective in producing real benefits for the public.

The long distance market is distinguished by the identity and characteristics of its sole historical occupant, AT&T, and AT&T's continuing control of the facilities its competitors must use to compete. Yet even these unique features will not prevent the achievement of workable competition indefinitely. We believe that the long distance market can be deregulated in a few short years, but only if the government establishes a comprehensive, well-reasoned plan for staged deregulation of AT&T.

We ask specifically that this Subcommittee investigate these issues and take appropriate action to assure that the FCC expeditiously develops principles to guide the demonopolization of the interexchange market so as to assure the public receives the maximum benefits derivable from competition.

In view of the fact that the Commission borrowed so freely from the MFJ in crafting its current transition policies, U.S. Telecom may perhaps be excused for borrow-

⁴⁶ NTIA report at 96.

ing from the same source to describe the situation these policies are creating. In citing the need for divestiture, the Court observed that the evidence adduced during the trial, and indeed the Commission's own admission, showed that the Bell System had been neither effectively regulated nor fully subjected to true competition and that, absent divestiture, the American consumer would face the specter of a Bell System "restrained by neither regulation nor true competition."⁴⁷

U.S. telecom respectfully suggests that, if the Commission does not rethink current policies by (1) recognizing that today the interexchange market is neither competitive nor contestable; (2) perceiving the critical state of development of the interexchange industry and the significance of current efforts to develop separate national transmission facilities; (3) acknowledging the continuing market domination of AT&T; (4) ceasing its ongoing attempts to *de facto* regulate AT&T by eviscerating the tariff review process; (5) accounting for the significantly lower use value of FGD access to the competitive carriers; and (6) developing a demonopolization plan that accounts for the preeminent consumer benefits universally agreed to result from the development of true competition in the market, the result will be, not a Bell System, but an AT&T, "restrained by neither regulation nor true competition." In light of these concerns, I appreciate the Subcommittee's attention and trust that your interest will lead to a fair resolution of these issues. Thank you.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR GOLDWATER AND THE ANSWERS

Question. Under the FCC's current plan, the OCCs will pay more for their local connection as local telephone companies improve the quality of those connections. You have asked the FCC to change its plan. Aren't you asking for a change of the rules in the middle of the game?

Answer. We are asking the appropriate government agency—hopefully, the FCC; but Congress, if necessary—establish some reasonable and equitable rules for the transition to a competitive marketplace.

The rules that exits today were essentially written by AT&T, not the appropriate government agency. The consequence is that the rules favor AT&T, not the competition. We are not asking for rules that would unduly favor us, but only for rules that are fair to everyone.

When Judge Greene approved the divestiture, he required the Bell Operating Companies to provide access to the local exchanges for competitive long distance companies that is equal to that furnished to AT&T; but, he left it to the FCC to define precisely what services and arrangements constituted "equal access". Despite the need and requests by several parties, the FCC has not defined "equal access". Instead, it has adopted the definition contained in the National Exchange Carrier Association (NECA) Interstate Access Charge Tariff.

NECA had not been staffed when the first Access Charge Tariff was developed, so the task was performed by Bell's Central Services Organization (which was, then, staffed and controlled by AT&T). the CSO staff wrote the tariff to define "equal access" as dialing parity (being, essentially, availability of 1+ dialing to the customers of all long distance competitors), automatic number identification (to eliminate the need to enter extra authorization codes) and answer supervision (an inter-office signal that indicates, for billing purposes, when a call has been answered and ended), but no more.

The FCC compounded the deficiency by approving a rate structure in the tariff which competitive carriers the same as AT&T when "equal access" is implemented. Yet, competitive carriers still do not receive all of the same services and benefits that AT&T enjoys. Only AT&T can provide 800 (in-WATS) and 900 service, automated credit card and coin-sent-paid service, and only AT&T has historical market data, multiple points-of-presence and no provisioning problems; and, it should be noted, all of these benefits were acquired by AT&T at the expense of regulated ratepayers during the monopoly era. It is certainly true that competitive carriers have more in the equal access environment than before, but the situation is still far short of the "level playing field." Therefore, it is unfair, unjust and improper to compel competitive carriers to pay the same rates as AT&T.

AT&T has argued that allowing competitive carriers to pay any lesser access rates constitutes a subsidy, but that argument is fallacious. Insofar as the competitive carriers receive less services and benefits than does AT&T but have to pay the same

⁴⁷ 552 F. Supp. at 170.

rates, the competitive carriers are actually subsidizing AT&T. That is an absurd result, especially considering the incomparable advantages stemming from its historic monopoly that AT&T already enjoys.

Question. What's wrong with letting AT&T cut its prices? Isn't this supposed to be one of the benefits of the divestiture?

Answer. The problem is that AT&T is cutting its prices for competitive services below costs, while increasing its prices for services where there is no competition. This is classic predatory behavior of a monopolist, and the result is injury to competition.

Examples include AT&T's "Reach-Out America" or Block-of-Time Tariff. This pricing scheme was admitted—by both AT&T and the FCC—to be below cost, but nevertheless allowed to go into effect by the FCC. AT&T has proposed a variety of other below-cost pricing schemes—such as "Pro-America" and "Accunet"—some of which are still pending before the FCC. At the same time, the FCC has allowed AT&T to increase by over 25% in some instances its short-haul toll (that is, long distance calls within the 1 to 55 mile band) rates, where AT&T has virtually no competition.

The divestiture and the advent of competition in telecommunications should result in lower long distance rates, and we raise no objection to those natural and proper consequences. US Telecom did not object, for instance, to the across-the-board rate decreases implemented by AT&T in May, 1984, and June, 1985, coincident with the implementation of end-user access charges. However, where AT&T's motive for price decreases is obviously predatory and anticompetitive, the public interest requires corrective actions.

It is certainly true that competitors could pursue a remedy for AT&T's action through the antitrust laws in the courts (and some may yet choose that action). But, the time such cases take to complete is a major concern. The Justice Department's case against AT&T (which resulted in the divestiture) lapsed seven years, and it was settled before a verdict was reached. The MCI case against AT&T in Chicago was filed almost eleven years ago, and is still in the appeal process. If competitors relied exclusively on the courts, they would likely be driven out of business by AT&T's predatory pricing practices before an appropriate remedy could be fashioned; and, the loser would be the public. There would be plenty of plaintiffs-in-bankruptcy suing AT&T, and the public would be denied the considerable benefits of choice in the price, quality and features of their long distance service that competition could have provided. In that event, the public would have suffered the agony of the divestiture for nothing. We would prefer that the FCC act now—perhaps encouraged by Congress—to properly manage the transition from monopoly to free, full and fair competition in the telecommunications marketplace.

Senator GOLDWATER. Thank you very much.

Mr. Goodman, do you have a statement?

Mr. GOODMAN. Yes, I do. Thank you, Senator.

Mr. Chairman, members of the subcommittee, I am Melvyn Goodman, president of Allnet Communications Services, a provider of long-distance telephone service. I also serve as president of CompTel, the association of the long-distance competitive industry. On behalf of Allnet and the association, I am grateful to the committee for this opportunity to address the question of how a real transition from monopoly to competition in our industry can be achieved.

In doing so, it is essential to examine to what extent the actions and policies of the FCC actually favored the creation of a genuinely competitive market.

I do not doubt that the FCC actions to date have been motivated by the best of intentions. But if the road to hell is paved with good intentions, we must be certain not to travel that road.

The FCC deserves much praise for being in the forefront of early efforts to launch the competitive environment, but it is now essential to focus the Commission's attention on the serious problems which threaten the transition to competition.

Competitive carriers have presented a comprehensive appeal to the FCC for prompt attention on several issues which are critical to the future of the long-distance telecommunications industry. The resolution of these issues will go far toward ensuring that the American public receives the benefits of competition, including the freedom of choice, innovation, and constant competitive pressures on the carriers to raise their productivity and enhance their services.

These issues involve, in particular, the inherent flaws in the transition process to a fully competitive environment and the premature deregulation of AT&T.

Mr. Esrey has already described the difficulties inherent in premature deregulation. I will therefore address my remarks to the current problems associated with the equal access process.

The transition process has been titled "equal access." But this title is misleading at best. A more accurate description is "improved but unequal access." I would like to note, briefly, four examples of how improved but unequal access is working to the disadvantage of competition in the long-distance market.

First, increased costs are suffered by common carriers due to unavailability of access tandems. For reference, an access tandem central office connects many local central offices together in circuits to such access tandem offices, thereby serving all those local central offices. Without access tandems, competing carriers suffer huge construction and software expenses for circuits to each local central office.

This is not imposed on AT&T which is already connected to every local central office. Additionally, the local Bell Operating Cos. are proposing to reduce the territory covered by a central office connection which will impose the need for further circuitry to reach the same subscriber base currently reached today.

Second, there is no common system utilized by the Bell Operating Cos to provide circuits. Information required by each operating company differs widely. Inadequate notice of proposed equal access conversions causes the need to guess on traffic and circuit requirements, and penalties are imposed for inaccurate estimates.

It is virtually impossible for administrative staffs to maintain any consistent activity as the rules change from company to company.

Third, central offices are converted on a scattered and fragmentary basis, without any reference to geographical proximity. This presents serious marketing disadvantages, as the competing carriers are required to use more expensive media to reach only those potential subscribers, as compared to AT&T's use of less expensive and more effective media.

It is a great deal easier for Cliff Robertson to say to everyone on national television, stay with us; whereas we must target particular customers in particular markets.

Finally, equal access from a technical perspective is only on the originating end of a telephone call. And that does not assure that the call will terminate on an equal access circuit.

Accordingly, there is no guarantee of equal quality, despite the fact we pay premium access predicated on originating service only. The competitive long-distance telephone industry has always em-

phasized self-reliance as well as innovation. What we seek from the FCC and Congress is no more than this: either genuinely equal access or prices for unequal access that recognize the inequality for what it is—improved, but unequal access.

The industry is not looking for a discount or a subsidy. What the competitive long-distance carriers seek is simply fair ground rules for competition, while paying only for what we get. Until such policy is adopted, equal access remains an illusion.

I am confident that the committee, having weighed all the testimony, will conclude that the current FCC policies not only fail to promote the transition to a competitive market, but may actually jeopardize the development of competition in this market.

Thank you, Mr. Chairman. I will also be pleased to answer any questions the committee may have.

[The statement follows:]

STATEMENT OF MELVYN J. GOODMAN, PRESIDENT, ALLNET COMMUNICATION SERVICES, INC. AND PRESIDENT, COMPTTEL

Mr. Chairman, members of the Subcommittee: I am Melvyn Goodman, President of Allnet Communication Services, Inc., a provider of long-distance telephone service. I also serve as the President of CompTel, The Competitive Telecommunications Association. The association and I are very grateful to the Committee for this opportunity to address the question of how a meaningful transition from monopoly to competition in our industry can be achieved, to the benefit of the American public and the American economy.

Two years ago, the Commerce Committee held hearings on the preservation of universal telephone service. It considered how the proposals by the FCC to impose new, fixed access charges on residential and business users would affect the ability of those users—virtually the entire American public—to use and benefit from the public telephone network. As a result of those hearings and careful consideration by Congress of legislation addressing the issue of access charges to users, the FCC substantially modified its proposal, to the benefit of all telephone users. Without that Congressional action, I am sure the original FCC proposal would have been implemented, resulting in a serious threat to the long-standing national policy of universal telephone service.

Today, these new hearings provide the opportunity to assess how far we have progressed toward the creation of a genuinely competitive market in the long-distance telephone industry. In doing so, it is essential to examine to what extent the actions and policies of the FCC actually favor the creation of a genuinely competitive market. I am confident that the Committee, having weighed the testimony, will conclude that current FCC policies not only fail to promote the transition to a competitive market, but actually threaten to extinguish competition in the long-distance telephone market altogether. I do not doubt that the FCC's actions have been motivated by the best of intentions. We all know, however, that good intentions do not always lead us where we wish to go. In this case, the complexity of the problem means that perfect foresight could hardly have been expected, but that is all the more reason why continuing Congressional oversight and review is needed. The FCC, in its zeal to push toward deregulation, is dismantling the constraints that prevent anti-competitive behavior by AT&T, long before the environment in the industry permits the other long-distance companies any possibility of competing on a fair and equal basis. Today, these companies are hindered by crippling disadvantages that exist owing to AT&T's past and present monopoly position.

The goal of a truly competitive environment is as much endangered by the policies currently being pursued by the FCC as was the goal of universal telephone service two years ago. Just as Congress concerned itself with the matter of user access charges, to the great benefit of the nation as a whole, I urge that Congress now concern itself with the even more momentous question of whether it will permit the FCC to allow the greatest free enterprise market restructuring in the twentieth century—one which has attracted admiration and emulation in many parts of the world—to be destroyed by regulatory short sightedness. The FCC deserves much praise for being in the forefront of early efforts to launch this restructuring. But it is now essential that action be taken to bring to the Commission's attention the seri-

ous threats to successful completion that are now affecting that market restructuring.

As you know, a group of the competitive carriers has presented a comprehensive appeal to the FCC for prompt action on several issues which are critical to the future of the long-distance telecommunications industry. The resolution of these issues will go far toward ensuring that the American public receives the benefits of competition, including freedom of choice, innovation, and constant competitive pressures on the carriers to raise their productivity and enhance their services. These issues involve, in particular, the transition to a fully competition environment—which are we believe to be in jeopardy—and the premature deregulation of AT&T, when this transition has scarcely begun.

Let me, therefore, first address the questions of how the FCC's deeply flawed approach to the transition process could abort competition before it ever has the chance to begin on an effective scale.

During this year and the next, many of the local telephone central offices throughout the nation will have been converted to provide long-distance telephone companies with technically improved connections to their customers via the local networks operated by the Bell Operating Companies. These new technical arrangements are undoubtedly superior to the inferior interconnections that were grudgingly and slowly provided in the past when this was required by the FCC. But this must not obscure the degree to which other long-distance telephone companies will continue to labor under very severe disadvantages relative to AT&T, the fact that many of these disadvantages are consequences of the way the transition to the new arrangements is being carried out, or the fact that many of these problems could be avoided by straightforward modification of the policies now being followed by the FCC.

I would like to address the specifics of the questions of network interconnection, because it is of such great strategic significance for the larger issues of public policy. The new interconnection arrangements are referred to by the FCC as "Equal Access". No description could be more misleading; so I shall refer to them instead as "Improved but Unequal Access". I would like to describe five notable examples of how "Improved but Unequal Access" is working to the disadvantage of the competitive long-distance carriers and the American public.

First, there is the important role of special central offices in the telephone network, known as "tandem switches", or simply "tandems". Equipment at these locations interconnect nearby local central offices. This means that a long-distance carrier with lines into the tandem can reach customers served by the local central offices much more efficiently, using fewer lines over shorter distances, than if each of the local offices had to be connected directly. AT&T already has connections to every local central office throughout the country. But because the Bell Operating Companies have been very slow to install access tandems, the other long-distance companies, hard-pressed to keep up with huge construction demands associated with the very rapid introduction of "Improved but Unequal Access", are required to obtain costly circuits directly to each of the local central offices. To add insult to injury, when the access tandems are finally installed, the long distance carriers then have to provide additional lines to connect them as well—piling up costs to their competitive disadvantage.

Moreover, managerial and regulatory chaos has made the ordering of these lines a costly nightmare of confusion, fraught with large potential penalties for inaccurate estimates driven by unreasonable notice requirements.

The competitive long-distance telephone companies have been forced, by the precipitate speed with which "Improved but Unequal Access" has been introduced, to order large numbers of new lines from Bell Operating Companies and other local telephone companies—known collectively as "exchange carriers". This would not be such a major problem if the ordering process were not subject to constant revision, and to inconsistent and confusing interpretations and applications of FCC policy by the exchange carriers. Some want access service to be ordered in terms of the number of lines required. Others want orders for access lines to be specified according to the number of minutes of telephone traffic to be carried. In other instances, exchange carriers classify long distance companies into different categories, according to varying definitions and use these categories in determining what kinds of facilities can be ordered under which tariffs. Some exchange carriers, for example, refuse to allow long-distance carriers to obtain local business lines under any circumstances, even though the exchange carrier's access service tariff specifically recognized that long-distance carriers may obtain such lines. Time requirements for the provisioning of access lines also vary widely across the exchange carriers. This

is hardly an environment conducive to the efficient and economic planning that would best serve the interests of telephone users.

Turning to a third critical issue, the Bell Operating Companies have been carrying out the conversion of telephone central offices to "Improved but Unequal Access" on a scattered basis, one central office at a time, rather than converting large groups of adjacent central offices located within the same community of interest at the same time. This places the competitive long-distance telephone companies at a crushing disadvantage relative to AT&T in using advertising and marketing tools to assist subscribers in making informed decisions. AT&T can inform and influence the public nationwide with its claims to be "the right choice", bring subscribers to stay with AT&T, using highly cost effective national advertising media. The other long-distance companies must communicate selectively with prospective subscribers, whose central offices are about to convert to "Improved but Unequal Access". The competitive long-distance companies must do this without confusing subscribers in adjacent areas which have not yet been converted. Generally, this means that selective and more targeted methods such as direct mail must be used, at a cost-per-prospect reached which is much higher than the costs for less selective and more effective media like television and radio.

Moreover, the unnecessarily fragmentary and scattered nature of the conversion process greatly complicates the work of planning and implementing the necessary additions to the networks of the competitive long-distance telephone companies. Thus, their small staffs are stretched by unnecessary complexities which AT&T, with its network connections already in place, need not face at all.

Here is my fourth example of the nature of "Improved but Unequal Access." Obviously, any telephone call links two locations—the originating and terminating ends. The full benefit of improved interconnection in terms of better service quality cannot be achieved until such connections are provided at both ends. The long-distance carriers other than AT&T have designed their network and their services relying on information provided in the local exchange carrier's tariffs submitted over the past year to the FCC. These tariffs indicated that the local exchange carriers would provide termination of long-distance calls throughout a wide service area—a Local Access and Transport Area of LATA—from a single point. Now, the local carriers have indicated their desire to restrict the access service at the terminating end of a call to "local, non-toll calling area", not the whole of the LATA. Such a change would cause the competitive long-distance carriers tremendous costs and would further aggravate the backlog in the supply of lines, an already serious problem. The network configurations planned by the competitive long-distance carriers would need to be completely changed. I need hardly add that AT&T already has facilities to terminate calls economically throughout each of the LATAs due to its ubiquitous presence, and would not have to change its network plans in any way.

My fifth example, I believe, is especially compelling and demonstrates the inequity of "Improved but Unequal Access". AT&T enjoys the benefits of premium interconnections everywhere in the nation. Importantly however, because of the piecemeal introduction of equal access, the competitive long-distance carriers and their subscribers cannot avail themselves of the full benefit of so-called equal access. Many calls originating from converted central offices must terminate in offices with the old inferior interconnections—those not yet converted. We pay premium equal access rates on the originating end of that call. Obviously, to have our subscribers benefit fully from improved connections, those connections must be utilized at both the originating and terminating ends at the call. Since less than a third of the nation's central offices have converted to equal access, most calls from converted offices are today going to central offices which are yet to be updated. For these calls, the competitive long-distance carriers are paying for equal access and not receiving even equal connections at both ends.

I hope that in this overview of a complex subject I have provided sufficient information to demonstrate why so-called equal access is nothing of the kind. The competitive long-distance telephone industry has always emphasized self-reliance as well as innovation. What we seek from the FCC and the Congress is no more than this: either genuinely equal access, or prices for unequal access that recognize the inequality for the access we receive. No one is looking for a discount or a subsidy. What the competitive long-distance carriers seek is simply fair ground-rules for competition where they pay only for what they get. Until such policy is adopted, equal access remains an illusion.

Until so-called equal access truly exists, all long-distance carriers are supposedly equal—but, if I may borrow a phrase, one of them, AT&T, is more equal than others. Much more. The advantages AT&T obtains from its history of monopoly are not limited to the biases built into the current FCC equal access policies. They

extend far beyond, and I will address the rest of my remarks to the implications of them.

The advantages conferred by AT&T's entrenched customer base, name recognition and ubiquitous network are obvious enough, but there are innumerable others. If I sought to cover every aspect of the unfair advantages that AT&T enjoys in the current state of the telephone industry, and under the present regulatory policies, I fear I would tax the Committee's patience. So I shall address only three of the most important issues.

First of all, the companies in competition with AT&T are at a severe disadvantage in their ability to market services because AT&T has most of the information about the telephone marketplace—information developed when it was the monopoly carrier and funded by the subscriber, paying monopoly rates. For example, AT&T currently has data on the patterns of usage by virtually all telephone users. Without similar information, the other long-distance telephone companies are at a great disadvantage in developing marketing strategy, while AT&T's usage data enables them to identify important market opportunities with great confidence. Lack of such information also greatly impedes our ability to accurately forecast future requirements. It places us at a severe financial disadvantage in deploying our resources for capital investment, which are already much more limited than those of AT&T. Finally, the competitive long-distance telephone companies are only able to obtain the names and telephone numbers of subscribers at a considerable cost. And this information contains none of the valuable usage data available to AT&T.

Turning to the second of my examples, I would like to take note of the numerous important services that AT&T can market which cannot now be provided by other long-distance companies at all, or which could be provided if enormous expenditures were incurred. Such services as 800 and 900 services, collect calling, pay phone calls, and automated credit card service as based on complex systems that were developed during AT&T's reign as a monopoly, were paid for by the general public and are now only available via AT&T. Even after so-called equal access is widely available, these valuable services will be denied to long-distance telephone companies other than AT&T. For example; the Bell Operating Companies have advised Judge Greene that they will not be able to provide the competitive long-distance companies with access for 800 service on the same basis as AT&T until 1988.

Thirdly, even the immediate implementation of universal and genuine equal access would not enable the competitive long-distance telephone industry to compete with AT&T on a fair basis today. AT&T's entrenched market position, unparalleled in the history of American business, was developed under monopoly conditions with enormous expenditures supported by rate payers who had no alternative to AT&T. AT&T has had the unique advantage that all telephone customers were automatically AT&T customers. AT&T is a deeply entrenched dominate carrier with enormous leverage with the long-distance user. Its established network enables it to offer quality service nation-wide. The advantages gained by AT&T at the expense of the public in the era of monopoly persist strongly into the present era, while a truly competitive telephone industry is just beginning to struggle into existence.

AT&T has vast resources with which to wage market warfare. It can be counted on to be a highly aggressive competitor. We can be sure it will bring its market power to bear because the divestiture has made long-distance the single most important area of business for the new AT&T. True parity in competitive terms between AT&T and the OCC's will inevitably be slow in coming.

The break-up of AT&T is an extraordinary event, requiring thoughtful and effective action in service of the goal of competition if its benefits—potentially immense—are to be realised by the public.

This holds true especially for the transition years immediately following divestiture. Most of the actions of the Judiciary, the Congress and the FCC clearly attest to the widespread recognition that such action is required to safeguard something that has become a fundamental and near universal experience in American life—economical, high-quality telephone service.

I have described but a few of the problems which must be overcome swiftly if there is to be genuine, fair and effective competition. Moreover, I must emphasize to the Committee that the FCC, to judge by recent trends, is not likely to take the affirmative steps needed to promote such competition.

CompTel, its member companies and the FCC all agree that the telecommunications industry should be deregulated as soon as market conditions ensure that effective competition exists. However, when the dominant long-distance carrier controls nearly 90% of the market, our nation is still a long way from effective competition in this critically important industry. Based on the traditional antitrust analysis used by courts, AT&T's overwhelming market share gives it the power to control

the marketplace and to manipulate pricing. It can drive the evolution of the public network to crush emerging competitors, to the detriment of the American public. During the transition to full competition, wise use of the Federal regulatory powers to facilitate this transition is the only reasonable course of action. The possibility of such Federal action is all that now stands between AT&T and the restoration of unrestricted monopoly control of America's long distance telephone service. Until AT&T no longer has overwhelming market power, it must be monitored and regulated by the Federal Government. Anything less would be a gross and unprecedented abdication of responsibility by our Nation's policymakers.

I would urge, Mr. Chairman, that the members of this Subcommittee, as a significant and timely first step, express their concern to the FCC over the potentially dangerous course of events I have described, much as concern was expressed previously to the FCC over the threat to universal telephone service.

I believe that the FCC should be required to answer two basic questions before it responds to the more specific concerns raised in our industry's request for an expedited rulemaking. First, how will the Commission remedy the glaring inequities in the arrangements so widely misnamed as "Equal Access"? Second, since it is totally implausible to suppose that the marketplace for long-distance telephone service can yet operate in a truly competitive manner when one participant holds nearly 90% of the market, how will regulations be used to identify, restrain and remedy the effect of monopoly power during this transition period?

An Administration and a Congress which espouse the benefits of a competitive marketplace now have before them the opportunity to act decisively to ensure that competition flourishes.

I very much appreciate the opportunity to present these thoughts and proposals today. If I can provide further information, please do not hesitate to request it.

Thank you, Mr. Chairman.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR GOLDWATER AND THE ANSWERS

Question. What's wrong with letting AT&T cut its prices? Isn't this supposed to be one of the benefits of the divestiture?

Answer. Price competition is one of the many benefits of divestiture but unregulated price reductions by AT&T in the short term will smother this competition in the long term. Pricing below cost by a monopoly carrier, or predatory pricing, is unquestionably recognized as unlawful by the courts and the FCC. In fact, the FCC recently rejected a rate reduction request by AT&T ("Pro-America") for precisely this reason. Is it good business or economics to deregulate a company with almost 90% market share? Absolutely not. The possibility is simply too great that such a company will resort to below cost pricing devices in order to gain more customers.

A related concern involves the likelihood that AT&T would use revenue from other monopoly services to make up for the revenue shortfall which the reduced-rate service would cause. Here, AT&T would cross-subsidize its reduced-rate service to sustain it while depriving other customers of rate reductions which they would otherwise receive. Such subsidization is to the detriment of those ratepayers who are most vulnerable since, in many cases, they do not have sufficient long distance usage to qualify for the reduced rate service.

Because of the ability of the OCCs to sell long distance service cheaper than AT&T, there is pressure on AT&T to lower its rates. In the face of this competition, AT&T has offered numerous proposals to reduce some of its rates—proposals which were never made when it operated without competition. However, price reductions must continue to be encouraged so long as they do not amount to below cost pricing.

Price competition will continue unless the FCC permits AT&T to set its prices at levels aimed to drive competition out of the marketplace. Congress must continue to monitor the FCC and ensure predatory pricing does not occur.

Question. Under the FCC's current plan, the OCCs will pay more for their local connections as local telephone companies improve the quality of those connections. You have asked the FCC to change its plan. Aren't you asking for a change in the rules in the middle of the game?

Answer. No. We have not asked the FCC to change its plan and, in fact, we will pay more when the quality of connections is improved but at this time, the FCC and the operating companies are asking the OCCs to pay for more than they are receiving.

The OCCs are not receiving premium access, but, in fact, are being asked to pay for it. Simple availability to the OCCs of Feature Group D access is not the same as the access available to AT&T. Numerous inequalities have persisted in the quality of interconnection received by the OCCs versus that obtained by AT&T even after Feature Group D is available to OCCs. Examples of these inequalities include uncoordinated cutovers, billing delays, unavailability of access tandems, unavailability of 800 and 900 service and coin call long distance, and unavailability of marketing data.

Even if viewed as a rule change, it must be pointed out that the quickly changing telecommunications industry cannot be bound by rules which were adopted several years ago and which lacked the benefit of knowing the precise nature of access that OCCs would receive. Today, the industry has actual knowledge of the inequalities associated with technical Feature Group D access. It is clear that the access received by the OCCs is substantially inferior to that received by AT&T.

Question. Please explain what the Indiana Switch is.

Answer. The "Indiana Switch" is a service which will be provided by a consortium which is one-half owned by twenty-seven independent telephone companies in Indiana and one-half owned by U.S. Switch, a company located in Longwood, Florida. U.S. Switch has formed in early 1984 for the express purpose of providing communications services, including equal access, to medium sized and small cities throughout the country. Within Indiana, the company has two divisions. The first, the IXC division, will construct a fiber network to the following Indiana cities: Bloomington, Elkhart, Evansville, Huntington, Indianapolis, Jasper, Kokomo, Logansport, Marion, New Albany, Plymouth, Seymour, South Bend, Terre Haute, Tipton, and Vincennes. The second division, the access division, will provide equal access to end users in some of the rural exchanges surrounding these communities through a tandem switch which will be installed in Indianapolis and trunked through the fiber network to the above cities.

Construction is expected to begin in early 1986 and regulatory authorizations are currently being sought. The company is studying intensively the provision of service to Illinois, Texas and Ohio. It is incorporated in twenty-two states, and intends to examine the feasibility of providing service in the remaining nineteen.

Senator GOLDWATER. Thank you very much, Mr. Goodman.

Mr. Chairman, do you have some questions?

The CHAIRMAN. Well, one of the concerns is that the OCC's may not be willing to provide service to the entire country or to all Americans who desire service.

What would be your response to that?

Mr. ESREY. Senator Danforth, our company, as I indicated in my comments, is spending \$2 billion to build a nationwide network. And when I use the word "nationwide," I mean a network that will reach into every one of the LATA's in this country, designed to provide a complete competitive alternative to the present AT&T network, accessible by every telephone in this country and terminating, obviously, to every telephone.

So our objective is nationwide service.

The CHAIRMAN. Mr. Goodman.

Mr. GOODMAN. Senator, the industry today consists of over 500 providers of long-distance service throughout the United States of America, so there are efforts in progress today to be competitive in every single market.

And further, as Mr. Esrey has said, there is transmission facilities being built throughout the United States which will create further opportunities for competition.

The CHAIRMAN. Now, let me ask you this general question. AT&T did not ask for divestiture. It was very happy with what it was doing. Divestiture came. There is now competition and AT&T is saying, as I understand it, "we didn't ask for this situation, but now that we are in a competitive market, let us compete. And competition means that we should be able to charge whatever rates we

think in a business judgment that we should; that this really should be a market-oriented approach. After being told that we have to compete, we are now being told that well, we really can't compete the way we want to compete."

You were asking for a period of transition. You were saying that real competition can't occur immediately. There has to be a period of transition.

When do we recognize the end of the period of transition? Is it a time frame that we are looking at, or is it a percentage of market that we are looking at? In your view, is there going to be some time when the FCC should appropriately say we will let market forces work?

Mr. ESREY. You have asked a number of questions. Let me start with the last one, Senator.

There is no industry of which I am aware that alleged to be competitive notwithstanding a dominant vendor having 90 percent of the market. It is almost a contradiction in terms. We do not have any experience of any industry that is truly competitive in its structure where the dominant vendor has anywhere near that proportion of the market and which in turn gives that dominant vendor power in the marketplace to do certain things that other competitors can't do.

That is true in this country or any other country where there are competitive markets. So I think one of the tests has to be what percentage of market indicates a really competitive structure; or, by definition, competition in my opinion can't exist.

I think, clearly, we are moving in the right direction. The American public will be better off for having gone through this breakup. The time to measure whether the breaking up of the Bell System has been successful or not is not 2 years after a system has been in place, or 50 years, but maybe 3 or 5 years down the road. At that point we will see if the American public doesn't have more choices of more types of service.

I believe that will occur and, although history will prove that the road was bumpy getting from here to there, but American public will be better off.

But you also can only have free competition when you really have equality in the marketplace and opportunity for competitors. If you are an AT&T customer, and I went into your home, and tried to dial the U.S. Telecom network to make a credit card call, I would have difficulty doing that. I would have to dial a lot of digits.

I am a customer of U.S. Telecom in my home and have equal access, and yet if you walked into my home and dialed zero, you would be connected to the AT&T network. Now, that is not equal; that is hard to compete.

There are other obvious examples of inequality. For example, 800 services is a multibillion-dollar marketplace. It's available only to AT&T. The competing carriers do not have an opportunity to provide that service right now.

If you go to a coin telephone and put in money to make a coin call, it immediately goes over the dominant vendor's system. That's not equal competition. So when you are struggling to compete with somebody that has 90 percent market share, and you don't have

equality of opportunity, that is not the time to say let's deregulate and see what happens. I think we know what will happen.

Mr. Goodman commented on a number of other difficulties in the transition that exemplify competitive inequality. So the time to deregulate is when you have demonopolized a market from a market structure point of view and when you truly have equality of opportunity amongst the competitors, where they really can compete on a level playing field and on the same footing.

Mr. GOODMAN. I have only one comment to add to that, Senator, and that is I think we tend to forget that the divestiture was a product of a settlement of an antitrust litigation. And when AT&T espouses that they didn't ask for divestiture, we should recognize its historical evolution. And we still are dealing with a monopoly that needs to be controlled.

The CHAIRMAN. Thank you, Mr. Chairman.

Senator GOLDWATER. Do you have any questions, Senator Gore?

Senator GORE. Yes, thank you, Mr. Chairman.

I want to continue to briefly explore one of the areas touched on by Chairman Danforth, and that is the service that can be expected in rural areas and low-density areas.

I live in Carthage, TN. I live on a farm outside of town, with only a couple of thousand people there. Are you telling me that you now plan to offer service to Carthage, TN, even though it is a very low-density area?

Mr. ESREY. We plan to build our facilities to connect into every LATA and connect into every telephone operating company.

I am not sure of your local operating company in Carthage. It is one of the Bell operating companies, I presume. I will be pleased to provide you with more specific information relative to Carthage for the record.

[The following information was subsequently received for the record:]

UNITED TELECOMMUNICATIONS, INC.,
Kansas City, MO, September 6, 1985.

Hon. ALBERT GORE, Jr.,
U.S. Senator,
Russell Senate Office Building,
Washington, DC.

DEAR SENATOR GORE: I wanted to write and thank you for the courtesies you extended to me during the Communications Subcommittee hearing yesterday on the issues facing the competitive long distance telephone industry. It was honor and a pleasure to attempt to answer your questions, and I sincerely believe that the information which you elicited during the hearing will significantly add to the ultimate resolution of the problem.

I did want to take this opportunity to, also, reaffirm some of the statements I made to you at the hearing about our commitment to serve all of the public. Our long distance subsidiary, US Telecom, is well into the construction of a 23,000 mile state-of-the-art digital fiber optic telecommunications network, which will reach into every state and LATA (local access and transport area) in this country. Once it is completed in 1987, we will have the ability to reach every telephone customer via the local facilities of the exchange companies (i.e. the Bell, Independent and cooperative telephone companies). Moreover, once those exchange companies convert their central offices to equal access technology, the local customers will be able to choose to reach our network by dialing 1, rather than the 12-15 extra digits they must dial now. How soon and how ubiquitous that service will be available to all customers, however, is a matter that is in the hands of the local exchange companies and the FCC. We will have done our part by 1987.

We think that it is important to be able to serve every customer. While it is certainly true that most competitive long distance companies seek to serve the big (and

therefore profitable) cities first, it is a hallmark of our plan to offer service to everyone, everywhere, in this nation, as a true competitive alternative to AT&T. And, as I mentioned at the hearing, unless competitive networks like ours are built, rural telephone customers are likely to suffer higher rates at the hands of an AT&T monopoly. I know from following your distinguished Congressional career that you are a champion of the benefits to the public that can be derived from competition; and, I want you to know that we are aggressively pursuing those public benefits in the long distance telecommunications market.

With respect to service in Carthage, Tennessee, I mentioned during the hearing that US Telecom has a switch in Nashville, and therefore offers originating service from that city. I have subsequently determined that South Central Bell Telephone Company offers LATA-wide origination for Feature Group B service in the Nashville LATA; which means that any South Central Bell customer in the proximity of Nashville (including Carthage) can use our service today by dialing a 7-digit number. In other words, if you would like to use US Telecom's long distance service from your farm (and, by the way, with significant savings off of AT&T's rates), I would be pleased to sign you up immediately. As I mentioned earlier, we would like to be able to offer this competitive alternative everywhere; but, in order to do so, the FCC must pursue a more reasonable transition from AT&T's historic monopoly to a genuinely competitive market.

With your help, and the appropriate action by the Senate Communications Subcommittee, we believe that guidelines can and should be established for the FCC to follow when pursuing to deregulation of AT&T. The FCC should not prematurely deregulate AT&T, it should not allow AT&T to engage in predatory pricing, it should require AT&T to justify its rates based on fully allocated cost standards, and it should not require competitive long distance companies to pay access charges for services and benefits that only AT&T enjoys. If I or my company can be of any assistance to you or your staff in developing such guidelines, please do not hesitate to call upon us.

Thank you again for your courtesies, your consideration of these important issues, and your concern.

Sincerely,

WILLIAM T. ESREY,
President.

Senator GORE. In that instance it is, although there are more rural telephone co-ops in Tennessee than almost any other State. And I want to ask you in a subsequent question about them.

Let's just take the example of Carthage, TN, 50 miles from Nashville, low population density, and you are going to serve that area?

Mr. ESREY. We will go into Nashville, TN, LATA, and that will enable us to do two things; to terminate any calls that originate anywhere in the country over a network and pass it off to the Bell operating company for completion to that customer.

In terms of originating calls in Carthage, whether we actually built the facilities or leased the facilities out from Nashville to Carthage would depend upon the total demand there.

Senator GORE. It would depend upon the population density in other words?

Mr. ESREY. Depending on the FCC and what they do in terms of LATA-wide termination and LATA-wide origination. We intend to have our long-distance facilities into that area, and we will therefore serve Carthage without reliance on AT&T's network.

Senator GORE. But you don't really intend to offer me that service out there on my farm, do you, because I don't live in a large city.

Mr. ESREY. Senator, we do not plan to build separate facilities from the central office out to your farm, and neither does AT&T. They don't have it. We would rely on the local operating company for the collection of the origination and termination of that call.

We would not duplicate the facilities into an individual residence or business. That would be duplicative and wasteful.

Senator GORE. You do not plan to market out there. You do not have current plans to allow people in rural areas to originate calls over your network.

Mr. ESREY. Yes, sir, we do plan to do that. I cannot tell you every area and I cannot tell you about your specific area, but the vast majority of the country—

Senator GORE. Of the population?

Mr. ESREY. Of the population.

Senator GORE. But I am talking about low density areas now. You do not really have plans to go at and try to serve those areas, do you?

Mr. ESREY. We do, because we will terminate our long-distance service into every LATA.

Senator GORE. I am talking about origination. To market your call origination service in low density areas. Do you have such plans?

Mr. ESREY. We do in a number of areas right now, and that ability will expand. Right now we would go out and we would get originating connections through the Bell operating companies or by FX lines, which is, in effect, a private line from Carthage into Nashville.

But we would order local origination facilities through the Bell operating companies, which would carry traffic into our facilities, be taken over our network, and finally be delivered back to the Bell operating company that provides local termination facilities to the called party.

Senator GORE. Now let us take the example of Byrdstown, TN, which is smaller than Carthage, and I think only about 70 or 75 percent of the people in Byrdstown actually have telephones because the rates are high and so forth. It is a very low density area. They are served by a rural telephone co-op. Would someone in Byrdstown who now uses AT&T for long distance be able to use your service?

Mr. ESREY. Yes, sir. As indicated, right now that call is being gathered by the local co-op in this case and turned over, interconnected in the LATA with someone, presumably AT&T. We will have facilities in that LATA and will be competing to have that call turned over to us if a customer elects.

The customer will have the choice to direct where it wants a call to go. Getting to Carthage or other towns will take longer, but we plan to expand very rapidly over the next few years, and to be in every LATA by 1987.

Senator GORE. What would it take from the FCC for you to do that?

Mr. ESREY. What we need are the guidelines to allow it. We can build our network. We do not need anything from the FCC except to be charged for only what we receive, as I indicated, and not more in the equal access transition. We must go to equal access so that you on your farm can make that choice. Without equal access, you do not have the opportunity to make that choice. That is progressing.

But the transition to equal access is difficult because it is unsystematic. For example, there might be only one end office in Nashville that is being cut over at a given time, with the others following at varying intervals. So we cannot market to you very well there because the conversion process is very spotty and very selective, and as a result we have to order services without tandem switches which would help gather the traffic that we talked about.

Without tandem switches, we would be forced to order lines to each central office servicing, for instance, Carthage, and that would be prohibitively expensive. So we have to get some transition rules in place that will allow us to compete and have the same advantages that the dominant carrier already has.

Senator GORE. Well, I hear you saying that if you get the right decisions then you will make a commitment to market in every community in the country.

Mr. ESREY. Over time, as we get our facilities built, which will be over a few years.

Senator GORE. Over a few years. How many years do you think it would take to begin advertising in Byrdstown?

Mr. ESREY. National advertising would be done very quickly. As you reach the critical mass and you have economies of scale, you do national advertising and you automatically reach Byrdstown.

Senator GORE. Wouldn't it make sense from a business standpoint if you were able to take your pick of all the markets in the country, wouldn't you concentrate on the high density areas and try to get the business there and then just leave the low density areas to AT&T? I do not understand why you would not make that decision from a business standpoint.

Mr. ESREY. The first priority is the large markets, and that is where our construction is undertaken. You go there first because that is where the business is.

Senator GORE. And with the lower rates. I mean, you are trying to compete on that basis. And the person you are competing with is serving Byrdstown now. You know what my concern is. Why wouldn't that result in a kind of subsidy on the part of the people who are not able to take advantage of competition in order for the dominant carrier to meet the rates you are going to offer in the high density areas?

Mr. ESREY. Without competition, Byrdstown will be worse off. We have recently seen AT&T raise their prices on short-haul toll by an excess of 25 percent in certain circumstances where they do not have competition, while they are lowering prices in areas where they do have competition.

And the small towns in rural America sooner or later are going to face that problem if competition does not get in there and offer them a true choice. We have customers that want to get in with a digital network on fiber facilities into Nashville and we will provide that. And once we are into Nashville we want to provide the opportunity then to interconnect with all telephones so that rural people will have an opportunity to select a competitive carrier.

I think competition will provide an alternative for those folks. Without competition, or competition only in selected markets, the high density markets—

Senator GORE. Is that a bypass operation?

Mr. ESREY. No, it is not bypass. Bypass would occur if you bypassed the local co-op. And that is what I am saying that we would not want to do. We will take our long-distance facilities into each LATA and at that point we will turn over to the Bell Operating Co's. the termination or the origination of those services.

There will be some cases in a very high density market where we may order special facilities from the Bell Operating Co's., using them, if you will, to bypass themselves. There can be other selected instances where we build our own facilities to bypass the Bell Operating Co's. That is not our desire and not our first choice.

Senator GORE. Those are all the questions I have.

Senator GOLDWATER. Go ahead. We have all day.

Senator GORE. Well, just one final question, then.

I will pursue this with other witnesses who are going to be here, but I just want to be clear on what you are telling me. You will make a commitment to go out and market your service and compete in every single community in this country. You are seriously saying that.

Mr. GOODMAN. Can I respond for a moment, Senator?

Mr. Esrey represents one potential provider of long distance.

Senator GORE. I did not mean to ignore you, Mr. Goodman. Please comment.

Mr. GOODMAN. But I think that your questions are very much on point on the issue of just where we are in the development of competition and why we are seeking the opportunity to provide a more competitive environment. As Mr. Esrey builds facilities and others build facilities, and as many other companies in this country concentrate on their retail distribution of those facilities, it is anticipated that Byrdstown and Carthage and others will all ultimately share.

But this is a transition process and one that requires a period of time, because the capital investments are overwhelming and they need to be developed over that period.

Senator GORE. Well, ultimately is a tricky word. Ultimately meant never for Byrdstown, TN, until the Government came in with REA and other co-op supports to provide that service.

Now I am wondering whether or not it is realistic—it is not a question of believing what you say; it is a question of assessing whether or not it is realistic to expect that your companies will really be out there competing in the rural areas where there is only one house per mile or whatnot.

Mr. ESREY. Senator, without effective competition, without really viable competition, no, they will never be served. But if competitors are viable, they will. We already have a switch in Nashville and we are building our facilities. Now it makes good business sense when you have those nationwide facilities in and at night to allow people in Byrdstown to use those facilities, especially otherwise during those periods when they would be lying somewhat idle. It makes sense to enter those markets and fill up the network.

It is relatively small incremental cost to provide that type of service. We will not do it by building facilities out to that farm house or that ranch house. That makes no sense. It would be uneconomic. So we will work with the local operating telephone company, the co-op, and try to take that traffic.

If it all goes to AT&T or if they go to a coin telephone and it is automatically routed to AT&T, we can never have effective competition because the competitors cannot get to a size where they can do national advertising and be effective. Effective competitors offer a choice not only in price; the network that we are putting in will offer what we believe will be a very distinctive quality improvement over what now exists.

We would like to see that go to Carthage and Byrdstown.

Senator GORE. Well, I appreciate your responses and I will explore this with other witnesses.

Thank you, Mr. Chairman.

Senator GOLDWATER. Thank you.

Mr. Esrey, this question I think should be directed at the entire business that you represent. You made a business judgment to enter the long-distance market and compete with AT&T. Now are you now asking for AT&T or the Bell Operating Co's. or others to subsidize your business?

Mr. ESREY. Absolutely not. As I indicated, we are not asking for a subsidy. We are only asking to be charged for what we receive. If we are charged more, which is the case right now, for what we receive, we will end up subsidizing AT&T, which is ridiculous.

Right now, if a call is made from a nonequal access originating phone to an equal access terminating phone, we do not get equal access, as defined, narrowly defined, by the FCC. We do not get answer supervision. We cannot tell when the other phone is answered. The capability exists at the terminating end, but it is not passed through to the originating end.

We cannot tell who placed the call. We do not get that number, so we have bad debt problems and so forth because we cannot identify if it is placed from a nonequal access phone. The customer has to put in an authorization code, which is subject to abuse. Yet the full discount we have for not having those things is cut in half in the instance that I just examined, although we get nothing for it.

Now we are starting to pay more and we have not gotten anything for it, and the result of that is a very unhealthy industry right now. You only have one sizable competitor that is even operating profitably, MCI, and their profitability has been substantially reduced. Every other major competitor is operating at a loss and the losses are increased.

That is a problem, I think, if we expect to have viable competition over the long run.

Senator GOLDWATER. I understand AT&T is operating at a loss now. Is that correct?

Mr. ESREY. No, sir. I do not believe that is correct. They are operating very near their allowed rate of return.

Senator GOLDWATER. Well, who is going to make the determination on that access charge?

Mr. ESREY. Well, the Federal Communications Commission is the agency with the responsibility for doing so. They have done so in the past when they set the access charge for the competitors of AT&T to be less than AT&T under a specific set of circumstances.

We are now asking them to look objectively at the set of circumstances that exists today and decide what that differential should be, if any. We believe it is not clear that the differential should not

be substantially retained, but that is the agency with the expertise to make that determination. We have not been successful in getting a hearing on that issue, and we would like, if necessary, this subcommittee to provide a request that the FCC do that.

Senator GOLDWATER. If we get legislation in this field, you realize that gets rather complicated. You may wind up with nothing or you may wind up with a lot.

Mr. ESREY. I understand, and I would hope that we would not have to find that legislation is the necessary remedy. I have a lot more faith in the system that we can work through these problems short of legislation. But legislation would be better than policies that are not going to bring competition and the advantages that will surely accrue to the American public.

If we do not have competition to survive, then we will not get the advantages, and that is the worst of all worlds.

Senator GOLDWATER. I do not mind telling you that the question that is in my mind relative to calling the Chairman or the entire FCC is what do we talk about and what conclusions can you hope to come to.

Mr. ESREY. I have provided in my written testimony a great deal of specific information and requests, and we filed in June a petition with the FCC for reconsideration of some of these issues. And the FCC as yet has not taken any action on it.

As I mentioned in my oral statement, in 1983 the FCC initiated a Docket 83-1147 to consider how, when, and under what circumstances AT&T should be deregulated. That docket has been lying dormant since that period of time, for over 2 years now, while AT&T has been deregulated on a de facto basis, as tariffs have been filed, and in some cases demonstrably where tariffs have been approved below cost.

Competitors cannot compete with a monopolist that has 90 percent of the market share under those circumstances.

Senator GOLDWATER. Well, are you not asking for a change in the rules sort of in the middle of the game?

Mr. ESREY. These rules have changed constantly. What we are asking for is a set of rules that would be set out that would be workable going into the future. We think those rules need reexamination and clarifying, I think that should be expected in an industry going through this type of turmoil and change. You have to be flexible and you have to be willing to keep adjusting as past policies turn out to be inappropriate.

Senator GOLDWATER. One other question on that point. You are asking the FCC to define equal access according to value as well as technical quality. Now how can the FCC quantify value?

Mr. ESREY. Sir, they did it before when they previously set the rates that competitors would pay for access. They did it, I think successfully, before and they launched, as Mr. Goodman said, the competitive industry. And I think that they are quite capable of doing it again. They de facto have done it again by setting the rates as they exist today.

Senator GOLDWATER. I think the Chairman said at that time that there would be adjustments as adjustments were shown to be needed. Am I right or wrong in that?

Mr. ESREY. I believe that is correct, and they are needed.

Senator GOLDWATER. Well, I think your presentation has pretty much gotten at the guts of this whole problem. I frankly cannot sit here or sit anyplace and see a solution. It is not easy to imagine AT&T cutting its long-distance prices. It is not easy to imagine the different companies you represent, or companies like you, being able to increase your prices and get away with it.

So if there is to be a solution, I do not think that solution has popped up yet. I do not think it is evident. I will discuss with the chairman of my committee the advisability, in his opinion, of holding hearings on this subject at this time. And, as I said at the outset, I do not think we have reached the point yet where we can by an expert, academic, technician, or otherwise, say this is what we have to do.

Just like the question being asked to you about Tennessee. I can ask you the same questions about places in my State that have one pay phone, and I cannot even remember how to pronounce the name, but we have them.

If there are no other questions——

The CHAIRMAN. Could I ask one question?

Senator GOLDWATER. Go ahead.

The CHAIRMAN. Do you think that the competitors of AT&T are in danger?

Mr. ESREY. Yes; I think they are, although that—I do not mean to be and I do not want to be alarmist about this. Let me start out by saying that the answer basically over the long run is the course that we are on. I think that we as entrepreneurs, and certainly Senator Goldwater, have seen the free enterprise system in the marketplace sort out a lot of difficult problems.

But that marketplace has to be given a chance to work its way through. We have a very unusual situation. We have had a natural monopoly that has been granted over years, and we are trying to transition from monopoly to competition. You have to use a lot of judgment to get from here to there.

That transition is very difficult now. You have the major competitors, with the exception of MCI, losing a lot of money and being squeezed with costs going up, because of some FCC decisions, and some pricing moves by AT&T that have priced some services, competitive services, demonstrably under their cost. Everybody will admit, I think, that they are under their cost.

You cannot get through this transition period when you have somebody that dominates the marketplace having free rein to raise prices where there is no competition and lower them where there is competition. Any of us would do exactly what AT&T is doing if we were allowed to. The surprising thing is that it is being allowed to happen.

That will endanger this transition period.

The CHAIRMAN. Is antitrust relief available?

Mr. GOODMAN. Excuse me, Senator, but that process is as complex as any other, obviously, and I think what Mr. Esrey has been trying to point out is that there are methodologies available to us to determine fairness and there is an expert body charged with that responsibility. The problems that we have brought to your attention this morning, they have not yet even commented on, and certainly a forum of this nature where they could examine those

problems and try to make a determination based on fairness is exactly what the competition is seeking.

Senator GOLDWATER. Do you have a question?

Senator GORE. Yes, Mr. Chairman.

Senator Hollings, as you know, has been extremely interested in this subject and has been a real leader on policy in this area, and he asked me to ask a question for him.

He has read recently about a proposal by a series of small telephone companies to give full service to all rural customers and he says the proposal is called the Indiana Switch. Are you familiar with that and could you comment on it?

Mr. ESREY. I have read about it, Senator. I believe it is a group of companies getting together to, in effect pool their buying power and then negotiate with someone to handle the long-distance traffic.

If my understanding is correct, I think that can be very beneficial and we would certainly like to negotiate with them to be handling off that traffic.

Senator GORE. Mr. Goodman?

Mr. GOODMAN. Yes, sir; that is exactly correct. As more and more providers of facilities are available to negotiate with, that opportunity for price benefits to the rural community increases.

Senator GORE. If you wish to elaborate on your response for the record, I am sure Senator Hollings would appreciate it, and I would also.

Thank you, Mr. Chairman.

Senator GOLDWATER. Thank you, and I would like to read it, too. My wife is from Indiana, and that is the only switch I ever heard of.

Thank you gentlemen very much. You have given good testimony.

Now the next gentlemen, first will be Mr. Robert Morris, securities analyst of Montgomery Securities from California, and the second will be Mr. John Bain, vice president—equity research, Shearson-Lehman Investment Bankers, from New York.

Mr. Morris, you can start off.

STATEMENTS OF ROBERT B. MORRIS III, SECURITIES ANALYST, MONTGOMERY SECURITIES; AND JOHN BAIN, FIRST VICE PRESIDENT—EQUITY RESEARCH, SHEARSON-LEHMAN INVESTMENT BANKERS

Mr. MORRIS. Good morning and thank you very much, Mr. Chairman. Today I have been invited to appear before this panel to present my outlook and opinion on the current and prospective structure of the long-distance market in this country from the vantage point of a securities analyst. As such, my comments will tie my outlook to the capital markets.

My current position and opinion is heavily influenced by my understanding of the conversion to equal access taking place today and the American Telephone & Telegraph Co. response to alternative competitors. My discussion will therefore focus on these issues.

My comments are also predicated upon two basic assumptions: One, that for whatever reason we entered into this, it was decided

that we wanted competition in the long-distance interexchange market; and two, that AT&T today, outside of the markets currently served by the local Bell operating companies and the other local exchange companies, controls 85 to 90 percent of the market. This control gives them market power, and without an appropriate transition process from that market control to a competitive marketplace, the objective we stated as No. 1, a competitive marketplace, will not be realized in my opinion.

I also believe that the current process to convert to equal access draws to question that procedure and that transition process.

I do not want this panel to misunderstand my position. I think it is an outcome of competition that we will see companies fail. I think this is healthy. I think this is necessary.

Historically we had a very significant cost differential between what AT&T paid and what its competitors paid to provide this service. That cost differential is going away, and as it does, it will take reasoned, solid management to provide competitive alternatives to AT&T. If the companies do not have that solid management, they will not survive and probably should not survive.

The consolidation, as I said, is unavoidable and healthy because, as a result of the FCC's actions, selected operating expenses, most notably access charges for the various participants, have increased and will, over time tend to converge. This will, in turn, reduce the operating profitability of the industry and will require, as I mentioned, skilled and disciplined management.

It is unlikely that those companies, again, that cannot provide that management, will survive. This in turn, though, should allow the remaining participants to enjoy a reasonable return on their investment and provide the citizens of the United States with greater choices than otherwise might be available.

Unfortunately, in my opinion, there is a risk that under the current transition process there will be few, if any, competitors remaining once access charges converge. If competitors do survive, we run the risk that we will have an era of profitless prosperity wherein the survivors do not enjoy offering the public the array of services that might otherwise be available, and are constrained from offering a truly competitive challenge to the dominant provider.

The current transition process is based upon the concept of equality. For access to the consuming public equal in quality, all competitors should pay an equal charge to gain that access. AT&T's access is defined as the standard, and the transition process envisions an environment wherein AT&T's competitors have similar access and pay similar access fees. Historically, of course, as we all know, AT&T's competitors had inferior access and therefore paid lower fees.

The transition to equal access is currently driven by the AT&T divestiture agreement and it appears that, although the black letter mechanical requirements of the agreement will be met, the broader policy issues surrounding the agreement may be missed.

My understanding of the agreement includes a belief that various competitors would have an equal opportunity to compete. The current transition process does not appear to provide that opportunity.

For example, until recently, any long distance user that did not choose a carrier was automatically assigned to AT&T. More importantly, in providing equal access to the competitors of AT&T, the OCC's, the Bell telephone companies appear to be providing them with access on a local telephone office by local telephone office basis, as opposed to a tandem switch. This serves to increase the OCC's costs, both operating and capital, and general administrative costs, more than otherwise would be the case.

Aside from the increase in operating expenses related to this technological issue, it appears that the current transition process increases the OCC's marketing expenses. Telephone company areas are not converted to equal access in large geographical blocks, as we all know. Thus, advertising methods designed to reach large geographical blocks are not cost effective, necessitating more expensive direct solicitation and selling techniques.

These techniques are constrained by the fact that the OCC's do not have access to usage records of the customer base, as AT&T does, which in turn reduces the effectiveness of these techniques and again increases their expenses.

Aside from the increase in marketing expenses associated with these two issues, the OCC's must obtain State authorization to provide services between local telephone company monopoly areas. These areas did not exist prior to divestiture, and subsequent to divestiture, AT&T automatically received those authorizations. This provided AT&T with a time advantage relative to the OCC's.

These combined factors suggest that although the OCC's may have and receive mechanical access equal in quality to AT&T, they in fact have not had equal access to the consuming market. This appears to have increased their expenses, reduced their profitability and reduced the market share gains that might otherwise have been possible.

Although one might argue that this is the price of competition, it seems that each of these issues is related to AT&T being there first, as opposed to superior competitive abilities.

While many of the OCC's are spending vast amounts of money to build and convert their networks to equal access, AT&T has been able to spend its money to develop new product offerings, reducing the OCC's to playing a game of catchup with their competitive tool currently limited to offering lower priced services.

Yet, as AT&T has shown, it has the competitive willingness to respond to this environment by reducing prices in selected market segments, reducing the effectiveness of the OCC's primary competitive tool. Thus, it appears that the OCC's do not have equal access to the market again, and if pricing pressures continue, will lose the primary factor that currently provides them access to the market at all.

Within this environment, it becomes questionable whether any healthy competitors can survive and provide a reasonable return on investment.

My conclusions seem to be sustained in the capital markets. For example, Allnet Communications Services, Inc., recently agreed to merge with Lexitel Corp. IBM recently sold its Satellite Business Systems to MCI Communications Corp. for something less than book value. The common stock of GTE Corp., parent company of

GTE Sprint, and MCI Communications Corp. are trading at historically low levels. In fact, at this point it is my opinion that there are few investors willing to truly invest in MCI or GTE. Instead, they view them as speculations.

If you want to take the bet that something is going to happen, that this industry will work out, go ahead and take the bet. But if you want to invest in the companies, it is questionable at this time.

Assuming it is desirable to avoid this situation, it will be necessary to address the issue of what equal access really is. I do not believe it is simply a mechanical definition. This has implications for the cost of access.

It will also be necessary to address the cost of playing catchup. This has implications for pricing. Without addressing these issues, it appears that the benefits of healthy competition will be diluted, if not lost.

Senator GOLDWATER. Thank you very much, Mr. Morris. Mr. Bain.

Mr. BAIN. Thank you, Mr. Chairman and members of the committee. Thank you for the opportunity to appear on behalf of Shearson-Lehman Bros.

I would like to pick up where Mr. Morris has left off and discuss some factors that I think are important from the viewpoint of the investing community, the providers of capital. My viewpoint here is not necessarily that of the telecommunications industry per se, but that of the investment community and the investment process, without which the funds, the assets and the capital required to implement this transition to competition and equal access will simply not be provided.

It is generally believed that investors dislike uncertainty, that both the actual managements of companies that invest the funds and the providers of those funds, all else being equal, prefer a certain environment to an uncertain one.

A very strong case can be made that the pace of change in this industry has increased dramatically in the past few years. Many things have been mentioned already today—Computer Inquiry II with its structural separation requirements; the access charge order, which is shifting billions of dollars of cash flows in the industry from one source to another; the restructuring of the Bell System and the consequences and uncertainties created by the modification of the final judgment, and some other factors which have been ongoing for a long time—new technology, the emergence of new service and of course the changing demands on the industry by the public.

Now that seems to have created a feeling among the investing public that the prospects are less certain, that their ability to commit capital to this industry with a reasonable expectation of gaining return is diminished.

Mr. Morris discussed the lack of market performance of the securities traded by these companies. He mentioned MCI Communications Corp., a very large company in excess of \$2 billion, which nevertheless has seen the market price of their stock decline 75 percent from its high.

We have seen companies like the major resellers forced to consolidate under the threat of becoming insolvent. Part of that insolven-

cy threat, which is really what a number of people have talked about today, is merely the problem that investors are not willing to commit capital under current conditions.

A lot of the uncertainties cannot be resolved right now, but I think one that this committee can resolve is the uncertainty as to what the ground rules are going to be. We have seen numerous changes in the access charge order. We have seen numerous changes in the restrictions on waivers granted by the Federal court administering the modification of the final judgment. That alone is a great source of uncertainty.

To have the spectre of basic changes in legislation occurring at this time would further increase this uncertainty and would probably not induce investors to make additional investments of capital.

I would point out for this committee's consideration that we are now only 20 months into the post-divestiture structure of the Bell System, and have not yet completed the first year of the equal access process prescribed by the Federal Communications Commission, which has 2 more years to run.

There are problems with the process. There always will be, and several other commentators have noted that there is no solution to this. You will never find a solution that is going to satisfy the interests and the desires of every party in a competitive marketplace. By its definition, that cannot be done because they are competitors and will have divergent interests.

However, I think a case can be made for giving the painstakingly thought out plans that have been developed in this industry over the past decade a chance to work, and let us see what the true progress of these companies can be.

I would agree with comments by the chairman that the investment community would probably be encouraged if legislation were not imminently forthcoming, and the ground rules, which at least we understand today, have a chance to take effect.

Now on the specific topics we have been asked to address: Under equal access transition, we do have a plan, however imperfect, jointly hammered out by Judge Greene and the Federal Communications Commission. It is not yet complete. It is about one-third under way. There is an active marketing effort under way, and it seems to be well received by the public.

Serious problem areas, such as unallocated customers, have been dealt with in a manner that seems reasonable, if not perfect, by the Federal Communications Commission. And again I would suggest that the rules be given a chance to work.

I would also point out that if changes are desired in this environment, that it is a fact of a competitive marketplace that there is no free lunch. There will be no changes in the ground rules or changes in the way the industry is administered that benefits all parties to the industry and the public. What benefits one company can be expected to work to the detriment of the others. The exception of course, would be a climate of increased stability and predictability which will enable all companies to plan accordingly.

Second, on the interim regulation of AT&T, depending on how you define a monopoly, I suppose that AT&T does today remain a monopoly company in large geographic areas of the country, those

rural markets which Senator Gore referred to, where they will remain for some time the only provider of long distance service. I will also note that AT&T will probably remain the provider of last resort in markets competitors do not choose to enter. So it is unrealistic for AT&T or anyone to expect immediate full deregulation of that company.

However, in many major markets today, and certainly under equal access, there will be a workable degree of competition. And in those markets, I think consideration should be given to a sensible, thought-out, well monitored program by which AT&T can get increased rate flexibility.

It does seem somewhat unfair to the consuming public and to AT&T to require that company to be encumbered by time-consuming, sometimes years-consuming, regulatory proceedings which prevent them from making timely competitive responses to new service and pricing offerings by their competitors.

That is going to have to be done deliberately. I believe that the Federal Communications Commission has taken some steps to begin that process, and although it is going to take some time, I think the market will best be served by freeing all competitors to act promptly in the interests of their own investors and the public as soon as possible.

That completes my statement. I think we would welcome any questions.

[The statement follows:]

STATEMENT OF JOHN S. BAIN, FIRST VICE PRESIDENT, SHEARSON LEHMAN BROS., INC.

INTRODUCTION

I welcome the opportunity to testify on behalf of Shearson Lehman Brothers with regard to current conditions in the interexchange telecommunications industry. I believe that the current state of confusion and uncertainty in the industry, unless corrected, will work to the disadvantage of investor and consumer alike, and that a clear statement of policy, with dependable ground rules for all competitors, will aid in an orderly transition to a truly competitive industry.

Shearson Lehman Brothers is a leading firm in the investment banking and brokerage industry, with offices nationwide and internationally. In addition to our extensive relationships with individual and institutional investors, we have investment banking relationships with many major corporations, including a number in the telecommunications industry. During our last fiscal year, we participated in financings as manager or co-manager for more than 100 domestic and international corporations, with transactions exceeding \$15 billion.

As a result of these activities, we have some familiarity with the concerns of both investors and businesses regarding the future path of the telecommunications industry, and it is these concerns that form the background for this testimony.

QUALIFICATIONS

Regarding my qualifications, I received a Bachelor of Science Degree from Rensselaire Polytechnic Institute in 1963, and the degree of Master of Business Administration from the Wharton Graduate School in 1969. I am a member of the Financial Analysts Federation, in which I hold the designation of Chartered Financial Analyst. I am a member of the New York Society of Security Analysts and the Fixed Income Analysts Society. I am a First Vice President in the Equity Research Department of Shearson Lehman Brothers.

My prior experience includes ten years with the American Telephone and Telegraph Company, concentrating on financial planning and regulatory matters. In 1979 I joined the investment banking firm of Salomon Brothers, and in 1981 I joined Lehman Brothers Kuhn Loeb. Lehman Brothers was acquired by Shearson American Express in 1984, leading to my current position. In my position as an investment analyst, I have authorized or co-authorized more than a hundred research and

investment advisory reports. I have previously submitted testimony to the Subcommittee on Savings, Pensions, and Investment Policy of the Senate Finance Committee, to the Federal Communications Commission, and to the New York Public Utilities Commission.

ISSUES DISCUSSED IN THIS STATEMENT

There is certainly no need to document the rapid pace of change that has characterized the telecommunications industry in recent years. In addition to the most dramatic of these changes—the breakup of AT&T pursuant to the Modification of Final Judgement—forces resulting from technological advances, deregulation, changes in the capital markets, and other factors appear to be significantly changing the ground rules by which the industry is run.

However, those ground rules do not appear to be stable or dependable, and that is the source of our concern. It is generally believed that investors dislike uncertainty, and will tend to avoid it. In addition, it is difficult for corporate managers of telecommunications companies to formulate long-range plans in the face of uncertain legal and regulatory ground rules. My basic argument is that the interests of the investors and consumers alike are best served by a stable, dependable set of ground rules for the industry. Specific details of telecommunications policy in our society may never be precisely optimal. Certainly it will not be possible to completely satisfy all the diverse parties of interest to the industry. However, from the perspective of the investment process, a known policy, even if imperfect, is better than none at all, or one that is constantly in flux.

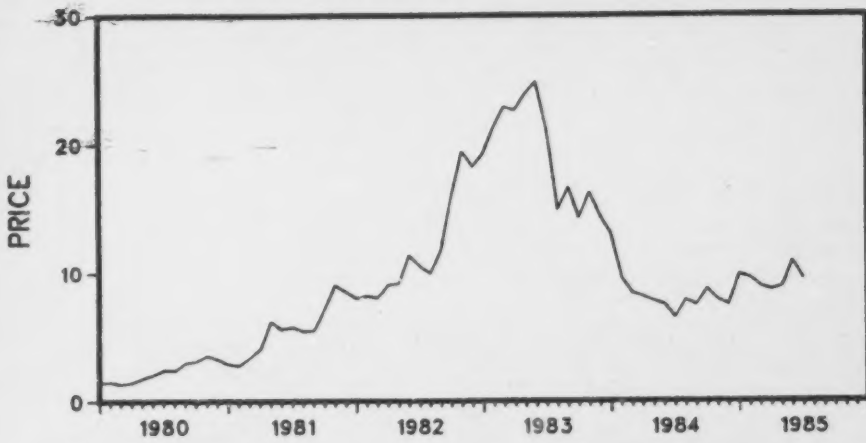
An examination of investor reaction to developments in the long-distance market in recent years reveals that there have been significant swings in investor confidence, and in the resulting marketplace valuation of the securities of the various industry participants. The accompanying graphs show quite clearly the rise and abrupt fall of investor confidence in MCI Communications Corporation, AT&T's largest facilities-based competitor, the decline in the market price of the stock of ALLNET, a major reseller, and even a sharp decline in market valuation of the stock of GTE Corporation, despite the fact that that company's OCC operation, GTE Sprint, is a small portion of their overall business. The message is clear: uncertainty harms the market price of affected companies. This in turn restricts their access to equity capital. I believe that a resolution of that uncertainty would lead to a more orderly market and aid in the overall development of the industry.

It is, therefore, not my intention to suggest what the appropriate telecommunications policy should be, for that is not part of my role as an investment analyst. That task lies to the parties directly of interest, including this committee, the various regulatory bodies, the companies involved, and the users of telecommunications services. The purpose of this testimony is rather to suggest areas of particular concern and to urge this committee to make its intentions clear to investors, industry participants, and regulators alike.

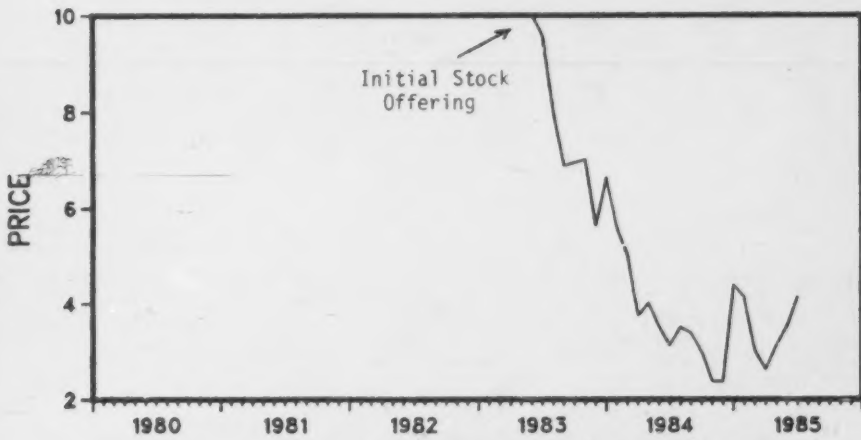
MAJOR ISSUES

The telecommunications industry is obviously complex, with myriad subjects for discussion. For purposes of this statement, however, I would like to focus on two topics that are of concern to investors, and that seem to be the source of much of the perceived uncertainty surrounding the industry today. The first of these is the appropriate treatment of the transition to equal access for interexchange carriers. The second relates broadly to the deregulation of today's dominant force in the industry, AT&T.

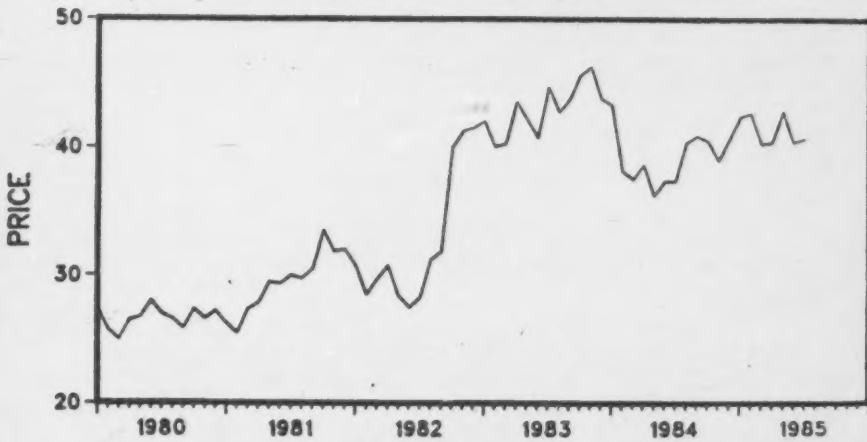
MCI STOCK PRICE PERFORMANCE



ALLNET STOCK PRICE PERFORMANCE



GTE STOCK PRICE PERFORMANCE



THE TRANSITION TO EQUAL ACCESS

As I understand it, the basic objective of the move toward equal access for all interexchange carriers is to permit competitors to offer service to the public that is equivalent to AT&T's own. In the past, AT&T's interexchange competitors—collectively referred to as the "Other Common Carriers", or OCCs—operated entirely under a system of local exchange access that has certain operational handicaps. Both network information and control and transmission quality were inferior to that available to AT&T, and the customer interface had certain disadvantages, including the need to dial multiple digits, a lack of detail call reporting, and other deficiencies. These technical handicaps were one of the factors leading to acceptance of the notion that the OCCs should pay a lower fee for access to the distribution plant of the local exchange companies than does AT&T. At present, under this so-called "unequal access", the OCCs pay a 55% discount from AT&T's rate.

However, we are now in the midst of a move to universal equal access—at least in areas served by the former Bell Companies. The original assumption, embodied in both the Modification of Final Judgement and in rules of the Federal Communications Commission, was that once equal access were available to the OCCs, they would become fully competitive with AT&T and therefore should pay the same rates for local access. Recently however, arguments have been raised in opposition to this assumption. Most familiar is the Booz-Allen-Hamilton study (BAH) sponsored by GTE Corporation that purports to show that the OCCs will not be financially viable under the current ground rules, and will in fact suffer a cost disadvantage if their local access charges rise to the level of AT&T's, despite the operational advantages of equal access. Although full details of BAH have not been disclosed, we have attempted to analyze the publicly available financial data for AT&T and its principal competitor. Some of the apparent cost disadvantage of the OCC can be explained on the basis of depreciation policy and capital structure, but it does appear that there is some basis for the BAH claim. This matter is before the Federal Communications Commission at this time.

Given the imprecision inherent in both the accounting process and in the methods used to allocate and recover costs in the telecommunications industry, it is likely that no "final" answer to the relative cost advantage question will soon be found. In addition, an economic argument can be (and has been) made that once a "level playing field" has been established, market forces should be given free rein. This point was made in a recent working paper issued by the Office of Plans and Policy of the Federal Communications Commission:

"... [in presenting the BAH study] GTE advocates that the government take additional steps to increase profitability and thereby stimulate additional entry and so make the [interexchange] industry 'competitive.' The government, of course, cannot 'make' the long-distance business competitive. Whether competitive market forces can be relied upon to allocate resources efficiently in this market depends primarily on basic economic conditions of supply and demand, which the government can do little to alter."

Office of Plans and Policy Working Paper No. 17, "The FCC, The OCCs, and the Exploitation of Affection," June 1985, p. 10

The paper from which this quote was taken makes an economic argument that even if OCC competition to AT&T is not financially viable in the immediate future, this is not necessarily a bad thing. Many new businesses go through a "start-up" period until turning profitable. It may be that some time will be required for investments to be put in place so that AT&T's competitors can become profitable. But to do so, those investments must be put in place.

On the other hand, supporters of BAH have invoked what is sometimes called the "infant industry" argument: that AT&T's entrenched dominance, scale economies, and (perhaps) lower historical cost basis give it a cost advantage that is inherently unfair and tends to create a playing field tilted in AT&T's favor. Certainly the recent poor stock market performance of the OCC securities mentioned above is one piece of evidence that investors fear that this is so.

THE BASIC EQUAL ACCESS QUESTION

With the above background, then, we can state the first basic question as follows: *If the OCCs are unable to operate profitably under current industry ground rules, what is to be done about it?* Before suggesting the possible alternative answers to this question, I note that there are four groups that have a financial stake in the answer. If the OCCs are unable to operate profitably under current conditions, one or more of the four will suffer financially. The groups are: investors in the OCCs, investors in AT&T, investors in the BOCs, and, finally, the telephone consuming

public. Here, it seems to me, are the options if the OCCs truly are not viable under current conditions:

1. Stick with the current "equal access, equal cost" philosophy. This would put the burden on investors in the OCCS. It might be expected to restrict access to capital for the OCCs, hence their growth.

2. Create a "subsidy" for the OCCs by implementing a discount on access charges, but require AT&T to reimburse the local exchange companies in an amount adequate to enable them to achieve their full interstate allowed rate of return. This is essentially the situation that prevails under "unequal access". In principal, it penalizes AT&T's investors, who would find AT&T to be either a less effective competitor (if AT&T raises prices to pass the subsidy along to its long-distance customers, thus maintaining its returns), or a less profitable business (if AT&T absorbs the subsidy in order to remain price-competitive).

3. Continue the subsidy, but put the burden of the discount on the local exchange carriers. This would keep AT&T whole, but would work to the disadvantage of the investors of the local exchange companies, who would find their companies either less profitable, or more susceptible to bypass of the local network, or both.

4. Continue the subsidy as in "3", but require the local exchange companies to pass it on to the end users. Since competition is supposed to benefit consumers in the long run, it could be argued that they should pay the up-front costs of establishing it. On the other hand, given the substantial increases in end-user charges already contemplated under the existing access charge plan, it is doubtful that this is really an available alternative.

Let me again note that it is not my intention to advocate any of these alternatives. I would merely hope to emphasize that, given that viable competition in the long-distance market is desirable, and yet appears to be unattainable under current conditions, something has to give. There is no "free lunch", and one or more of the groups mentioned above will have to bear the financial burden of assisting the OCCs towards a position of true competitive equality with AT&T, if that is to be the goal.

From my viewpoint as an investment analyst, it is not even critical which of the alternatives, or which combination of them, is adopted. What is disrupting the investment process, with potential harm to investors and consumers, is the uncertainty, and the "on again, off again" approach of the FCC on the question of equal access and the OCC discount. A specific resolution of this policy question may cause some immediate losses to some investors who are directly affected, but it would have the long-term beneficial effect of clearing the air and permitting investors and industry managers alike to make their plans and place their bets in a more certain environment.

THE DEREGULATION OF AT&T

The second major area of uncertainty regarding the interexchange transmission business is the question of when, and to what degree, AT&T's interexchange business will be deregulated. This topic presents a number of questions. Among them are the following:

1. Is it reasonable to expect AT&T to be able to compete effectively if the company is subject to extensive, costly, and time-consuming regulatory proceedings for every change the company makes in its price and service offerings?

One answer could be that, in those markets where AT&T faces competition, it doesn't seem to make much sense. An alternative is to invoke the "predatory pricing" and "cross-subsidy" arguments and note that despite significant competition in some markets, AT&T remains essentially a monopoly in others. A middle position might be to note that although there are probably substantial portions of the geographical area of the United States that will not soon be offered competitive originating service by the OCCs, their current rates of growth lead one to believe that the great bulk of the *population* will soon have competitive alternatives, and that through such devices as WATS resale, nationwide termination is a fact for most OCC customers today. Therefore, although there may be a small portion of the population that will be disadvantaged by the emergence of competition, it can be argued that its benefits are increasingly available to the bulk of the market. This argues for allowing more time for the transition to progress before forming final judgements on its impact.

I would also note, with regard to the predatory pricing issue, that deregulation in no way implies repeal of the antitrust laws. Unlawful anticompetitive behavior on the part of AT&T, or any other interexchange carrier, including predatory pricing, undue price discrimination, and other alleged potential evils, would still be subject to control by the same processes that presumably control them in other competitive

industries. Full-blown *ex ante* regulatory review is not necessarily required to prevent illegal acts, and I believe that there will be no shortage of parties standing ready to call attention to any illegal future pricing activities by a deregulated AT&T.

2. What about the rural "skim milk" markets? Does it make sense to require AT&T to be a "carrier of last resort" in markets nobody else wants to serve?

This is a very difficult issue. The very fact that thin-route, low-traffic areas are not being addressed by the OCCs is fairly strong evidence that they are high-cost, low-profit services, which, under today's nationwide average pricing policy would not be profitable on a stand-alone basis. In other words, they are being subsidized by AT&T's higher-density, competitive service areas to such an extent that none of the OCCs feels they can make a profit by entering them. This sounds like somewhat of a competitive handicap for AT&T. On the other hand, it is clear to everyone that such high-cost services are nonetheless essential and must be maintained. It is in no one's interest to create a situation in which service becomes unaffordable. The Universal Service fund of course cures a portion of this problem, at least so far as AT&T's competition from the OCCs is concerned. The threat from the construction of private systems—the so-called "bypass"—may be more difficult to address in the long run.

I believe that over time, subsidies are simply not compatible with competition. Given freedom of choice, those low-cost, high-volume users of telecommunications services who are paying the subsidies will tend to avoid them, leaving the common carrier network if necessary. Who will then support the high-cost customers? In the past, given AT&T's commitment to universal service, the high cost customers were offered long-distance service at the same price as that offered to low cost users. A truly competitive industry may not be able to support that practice. Some industry observers have jokingly spoken of "phone stamps," but some thought should be given to the possibility that some overt subsidy mechanism may some day be necessary.

Are we talking here about geographical deaveraging? Perhaps. It could be noted that the OCCs already have "deaveraged" their toll rates. True, each OCC offers the same price schedule to all customers it actually serves, but in Denton, Montana, MCI's service price is infinitely high: you cannot subscribe to it at any price.

The question of deregulation is important to AT&T, to its competitors, and to investors in all. As with the topic of equal access, I do not advocate any particular policy, only that same clear policy rules be set, with some assurance that they will be enduring.

CONCLUSION

I have argued that conditions in the interexchange telecommunications industry have become increasingly uncertain, due in part to a constantly changing set of legal and regulatory ground rules that makes it difficult for investors, as well as industry managers, to assess the long-term prospects and risks they face. Although everyone would prefer to find the "perfect" ground rules and policy for the industry, it appears that the existing multiplicity of diverse interests insures that such a condition will never be reached. To resolve the uncertainty that has been plaguing investors, and adversely affecting the stocks of the OCCs, some consistent, durable policy decisions are badly needed. Particularly in the two most pressing areas of uncertainty—the equal access transition rules and the deregulation of AT&T—a prompt statement of policy would go a long way towards restoring the investor's confidence in his ability to assess the prospects for the future, and of managements in planning for it.

Thank you for the opportunity to testify on this matter.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR GOLDWATER AND THE ANSWERS

Question. Do you believe the market is competitive?

Answer. This question can be read two ways. The market is not competitive in the classical economic sense because of the dominant market share of AT&T. I suppose an economist would describe it as a "Price/Volume Leadership" industry or an Oligopolistic Monopsony, or some such.

However, for purposes of the current debate, I think the important point is that the market has the potential to be competitive, and seems to be moving in that direction. I believe that the underlying supply/demand characteristics of interex-

change telecommunications are such that the industry can support more than one supplier.

Question. Should the FCC complete its inquiry into the telecommunications market and the long-run regulation of AT&T before it lessens its regulatory scrutiny of AT&T's rates?

Answer. No. The FCC can do a number of things to lessen the time delays inherent in the regulatory process, without completely deregulating AT&T. At some point, a market-by-market or route-by-route deregulation may be mandated by market conditions, although this would go against the principle of nationwide price averaging.

Question. Do you think that deregulating AT&T too quickly will interfere with competition?

Answer. I would say that deregulating AT&T *too much* would be the problem. There should be no doubt that if AT&T were completely free of regulation, the company would have the potential market power to engage in "predatory pricing" and other perceived ills. However, I do not think that AT&T would find it in their own self-interest to behave in an anticompetitive manner. To me, deregulation means that all interexchange carriers should have freedom to offer a wide range of pricing and service options to the marketplace, on a timely basis.

Question. Do you think the competitors are having a difficult time attracting customers? Why?

Answer. No. AT&T's competitors as a group have grown from virtually zero ten years ago to something in excess of \$4 billion today. Given that AT&T was in business for the better part of a century, and that most of its customers were pretty well satisfied with the service, that actually represents very rapid penetration of the market. As with any new enterprise, however, the competitors will quite naturally find it more and more difficult to attract additional customers. In other words, the "easy money" will run out. In addition to the fact that AT&T itself is becoming more competitive, there seems to be a sizeable portion of the market that simply does not care very much about interexchange rates. Customers who make few or no long-distance calls will probably never be interested in signing up with one of AT&T's competitors.

Question. How does the MCI/IBM deal affect competition?

Answer. At present we do not know what IBM's strategy will be. My view is that there will not be a direct competition between AT&T and IBM for their respective basic businesses. For AT&T that is, of course, interexchange transmission and switching. For IBM it is mainframe computer. What we might see, however, is competition between the two in the emerging "office of the future" market. I suspect that IBM will remain a fairly passive investor in MCI, and that time will show that IBM has in reality withdrawn from the long-haul transmission business.

Nevertheless, there is a clear perception in the industry and in Washington that IBM is now in the interexchange business. Certainly IBM's presence has given a lot more credibility to the future viability of MCI. As such, I would conclude that the "staying power" of MCI has been enhanced, and with it the prospects for viable competition.

Question. What conclusions about the market can be drawn from the fact that IBM, with all its resources, was unable to make SBS a profitable company?

Answer. The immediate conclusion is that satellite technology is not particularly good for voice grade telecommunications. The original business plan of SBS called for rapid development of broad-band business telecommunications: videoconferencing, high-speed facsimile, data transmission, etc. None of these markets have developed as predicted. In addition, the rapid rise in the cost of satellite facilities, due primarily to insurance and launch fees, have reduced some of the apparent economic advantages of satellite technology. Finally, the tremendous technological progress in fiber optics has made that the technology of choice in many applications that once would have been candidates for satellite technology.

As a result of these factors, SBS found itself unable to make a profit in the markets it originally intended to serve, and unable to penetrate the traditional telecommunications business.

Question. Do you expect IBM to expand or lessen its interest in telecommunications in the coming years?

Answer. I believe that it would be just plain good business for IBM to keep its options open. I do not foresee a battle with AT&T over voice-grade service. However, if a big market for broad-band business communications does develop, it might make sense for IBM to develop that capacity so that it can become a complete systems provider.

At present, IBM itself is not a factor in the interexchange transmission business, but it could become one in the future.

Senator GOLDWATER. Thank you very much, Mr. Bain.

Mr. Chairman, do you have questions?

The CHAIRMAN. Gentlemen, if the FCC called you up and said we would really like your advice as to what we should be doing about long distance telephone service and pricing, what would you tell them?

Mr. MORRIS. My response, Senator, would be that they need to look at the original intent of entering into this process of deregulation. It appears to me that they are currently defining the process of the evolution to competition as running parallel with the process of providing a technologically equivalent process of access for you and me to any one of the long-distance carriers.

I would suggest that they broaden the issue to include a definition of what equal access truly means.

The CHAIRMAN. What advice would you give them with respect to—let us assume everybody's objective is about the same, I guess. Everybody's objective is that we continue to have a system where everyone in the country can receive affordable telephone service. We like the concept of competition, I guess. At least we are committed to it, to change. But that particular egg has been scrambled.

What we want now is the best result from the present trends. We want AT&T to do well. We want its competitors to be in a competitive position. We want the benefits of competition to be realized in the form of affordable rates, and we want everybody to have telephone service.

So if you were advising the FCC, what would you be telling them?

Mr. MORRIS. Again, I think I would tell them to look at the broad issue of what is truly implied by a competitive marketplace.

The CHAIRMAN. I understand your testimony to be you would tell them to basically stack the deck for a little bit longer.

Mr. MORRIS. No, I would not tell them that. I would tell them, that I would tell them, one to examine the timing process and what it means to move to a competitive marketplace—that timing process being a technological, mechanical process of dialing 1 and getting access to whatever service; and two, provide equal access to the marketplace by the competitors.

That would be my first point, to look at that broader issue, and two, require those companies to pay for what they receive.

So I would not see it as stacking the deck.

The CHAIRMAN. Do you think AT&T should have flexibility to set their own rates?

Mr. MORRIS. In those market segments where it is demonstratable that they have competition and are not capable, through setting those rates, to eliminate competition or severely handicap it, and that they should be given flexibility in those areas, yes.

Mr. BAIN. Senator, there is a danger of overstretching metaphors, but if I could talk about stacking the deck, I would refer to it as the cards having been dealt. The various participants have picked up their hands and some of them don't like them very much. They are saying can we have a draw and maybe replace some of these cards?

I guess what I am suggesting to the FCC is to let the hand be played out. The rules are not perfect, and certainly no one's hand in this industry is equal. And the various competing parties will of course seek to structure the industry and the ground rules the way that they think best benefits their interest and those of the public. But the facts are not known.

The CHAIRMAN. "Stay the course," you'd tell them?

Mr. BAIN. Yes, sir; and give it a chance. There is a 3-year plan to implement equal access, which appears to be workable—not perfect, by any means, but workable. We are just now beginning to bring equal access services to large segments of the population, and I would suggest that it is a little bit premature to predict that this is a disaster for the public or for the participants or for AT&T or for anyone, and that it should be given a chance to work.

There certainly has not been any lack of consideration of this topic over the past decade or so, including by this committee.

I would also like to say one thing about the pricing flexibility issue, which is a point I make in my written testimony. Many observers have noted that the antitrust laws are not repealed by computer inquiry 2 or by the modification of the final judgment, and there will be no shortage of parties standing ready to point out any predatory pricing or otherwise illegal activities by AT&T or any other carrier.

So I think the danger of any truly illegal or economic abuses of pricing flexibility are overstated.

The CHAIRMAN. But isn't the antitrust law a very cumbersome process. Would the OCC's survive if antitrust relief were the only thing open to them?

Mr. BAIN. Again, there is danger in generalizing, but I would point out that the major competitor to AT&T has two antitrust suits still in progress. They are 10 years old and they seem to survive.

The CHAIRMAN. That is the point. Antitrust lawsuits go on and on and on.

Mr. BAIN. Yes, sir, but the penalties can be severe. I don't think anyone—

The CHAIRMAN. But that is no consolation to someone who has already gone out of business, is it?

Mr. BAIN. No, sir; I concede that.

The CHAIRMAN. You disagree, don't you, Mr. Morris, with Mr. Bain? Or do you?

Mr. MORRIS. My sense is that the cards have been dealt. When the game started we thought we were playing a game of five-card draw. It now has ended up to be a game of bridge and is slightly more complex, involving a number of different parties in the game.

So what we had originally understood when we entered the process is something that is different as it is evolving. It is an evolving industry. That is one point I would make in disagreement.

The other point I think I would make is we have basically 1 year, and technological "equal access" is to be completed.

The CHAIRMAN. We have what?

Mr. MORRIS. Basically 1 year, through September-October, 1986, by which most of the conversion process is to have been completed. So we do not have a long time to deal with. We have already spent

2 years of that time, of the 3-year process we had available to us, trying to decide what the issues were.

For example, the issue of default allocation just came through in the second quarter of this year.

So I take a different point of view than Mr. Bain on those two points.

The CHAIRMAN. As I understand it, what Mr. Bain is saying is that what we need is predictability. What we need is something that people can count on, not rules that change all the time. And that if you establish predictable rules, then things will work out.

What you are saying is that the OCC's are in real trouble, that they are not going to be doing very well on a "stay the course" position, and that they are going to need some greater protection than perhaps the FCC appears to be willing to give them. Am I correct in stating that?

Mr. BAIN. Maybe I can clarify my view a little bit, and perhaps a brief history of what happened with MCI is instructive.

In MCI's early days, they faced some strong competitive responses from AT&T—WATS, 800 service, Telpak and Hi-Lo tariffs, some of which were later declared unlawful. And for years, MCI had a very difficult time raising capital. Their stock languished far below the original offering value. It sold, I believe, as low as \$1 a share at one point.

Then all of a sudden MCI got a break. It was called Execunet. They got a break on access charges, called ENFIA. And the stock soared up to an equivalent of about \$80 a share. There have been some splits since. And the investors were then euphoric. Then along came something called equal access and all of a sudden the investors were discouraged and the stock has lost 75 percent of its value.

My remarks were, again directed from the viewpoint of the investment community and the investors in the stocks, it may well be that under these rules some firms will fail and some others will succeed. My only point is that under constantly changing ground rules, it is very difficult for us or the investors or indeed the managements themselves to figure that out and to do a job of planning for the best way to bring these services to the public.

The CHAIRMAN. Thank you, Mr. Chairman.

Senator GOLDWATER. Thank you.

Do you have any questions?

Senator GORE. Just a couple of brief ones, Mr. Chairman.

Both of you make your living, in part, by reviewing all the information you can get on this business area and analyzing it. How is the FCC doing, from your standpoint, in collecting the right information and monitoring this process? Are they doing a good job or a bad job?

Mr. BAIN. Anybody who has ever looked at accounting knows it is completely baffling. In fact, I guess I could suggest that if any of these companies are having problems making money, they should hire a new accountant. That is the first thing they should do.

But given some of the basic arbitrariness, yes, the main thing that I think the FCC should be congratulated for is over the last half decade, really the last decade, having acted promptly. It sometimes seems as though these problems are with us forever, but

there has been very, very substantial progress in bringing the benefits of competition to the public.

Ten years ago we had monopoly in the provision of customer premises equipment. That is now clearly competitive. Now that in effect has been done. It has problems. Companies are going broke every day. But it has been done, and it is believed that that has benefited the public.

We have made very substantial progress in bringing the interexchange monopoly down from 100 percent to something less. Now it is not equal; perhaps it never will be.

That has been a pretty remarkable performance, and I think the mere fact that the FCC has been willing to go forth, establish policies and attempt to enforce them, knowing that they are not going to be perfect, is one of the strongest compliments I could give them.

Senator GORE. Well, the question is really somewhat narrower than that. I want to know whether or not the FCC is collecting sufficient information about the long distance marketplace and whether or not it is overseeing AT&T's allocation of costs in a diligent manner. Do you have a feel for that?

Mr. MORRIS. The information that I am privy to or that I can ferret out when I go through there does not permit me to comment on whether it is in fact successful in determining that the costs, say in the equipment area, are fully justified or not.

In the information I have been able to put together, at least, it is apparent that the gathering process, over the past 2 years, has been difficult, and it is improving almost monthly since they tore these companies apart.

Senator GORE. It is improving but it is extremely difficult?

Mr. BAIN. Yes. Again, the Uniform System of Accounts and many of the detailed reports that the FCC requires of AT&T, and to a lesser extent, the competitors, were developed in a monopoly environment and were not designed to produce the necessary information. I don't know the facts, but I would suspect that even the carriers themselves have some puzzles they are trying to solve right now.

I don't think we have perfect information, but I do think that with the FCC continuing detailed monthly oversight of AT&T's financial picture, and requesting occasional reports from the other carriers, that they feel they have sufficient information to judge the pace of that competition.

Senator GORE. Well, looking at some of the information that is available, it seems to me almost impossible to determine what each service costs. And I know there are inherent difficulties when you have joint costs in providing different services, but it does seem to me at times that we could get better information about whether or not there are cross-subsidies between different kinds of services.

Let me just ask one other question. You raised the subject of management, Mr. Morris, in your testimony, with respect to the OCC's. Some critics have suggested that problems experienced by the OCC's are significantly due to management problems. I mean, given the competitive environment and the imperfections of the marketplace, it is of course not a full explanation for what the problems are, but I am wondering, since you raised the subject and since there have been some examples of very large prices being

paid for long distance operations, to what extent do you believe mismanagement is an explanation for some of these difficulties?

Mr. MORRIS. From what I can discern at this point, what is taking place is clearly a transition. You had a management team making decisions in the past, for example, concerning what an operation might or might not be worth. The game has, as we said, changed in midstream, if not the latter part of the stream.

We have moved from what I would call a price arbitrage environment to one where it appears that stronger management is needed.

I think you are seeing a change in many of the managements which brought these companies into existence.

If you look at, for example, GTE Sprint, it has gone through a number of management changes. You can see, as I mentioned before, the merger of Allnet and Lexitel, where you see a merging of managements. U.S. Telecom also had changes in management.

So there is this evolution in many areas to a new form of management.

Senator GORE. Did you want to comment?

Mr. BAIN. I think the technicians in all these companies are pretty good. They know how to build a communications system and operate it. To the extent there were misjudgments made, I don't believe that they were because of ineptness or incorrect analysis on the part of the managements, but because they assumed that certain ground rules that existed at the time they made those decisions would continue, and they have been changed in a way that now perhaps makes some of those investments look inadvisable.

That is part of the problem of having a constant flux in the basic regulatory and legal structure in which this environment operates, and it is one of the things that scares investors.

Senator GORE. Thank you.

Senator GOLDWATER. This question is to both of you. What impact will the investment by IBM and MCI have on the opportunities for competition by the smaller OCC's in the long-distance market?

Mr. BAIN. If I could offer one observation, I think almost everyone's reaction to that is that there is now a second very, very large entity that appears to be interested in this long-distance business. Some people observe that in fact, the MCI-IBM transaction is an exiting of IBM from direct participation in that long-distance business.

But if IBM wishes to make an investment in that long-haul transmission business, there is no question they could do it. So that brings a large source of potential capital to the industry.

I would have to venture, Mr. Chairman, that there will not be 100 facilities-based nationwide carriers in existence in 20 years. I believe there will be several. I think the industry is large enough and the technology robust enough to support several large viable competitors. But clearly, a large number of companies, particularly many of the resellers, got caught up in a gold rush mentality and assumed that some discounts and some pricing and marketing advantages would be there forever. And recent events have proved that they won't. That will be part of the consolidation that others have referred to here today.

Senator GOLDWATER. Well, I asked that question because while we don't have a graph for each company, GTE has had a pretty good increase in price from about 1982, including 1985, while Allnet has had a very precipitous decline in price, and MCI, the one I questioned, starting in about 1980 had a very nice increase up until about 1982, then a very drastic decrease, with a leveling off starting in 1984 and an apparent increase.

I just wondered if a large investment by IBM would make them more competitive, combined, more competitive with AT&T than they are now.

Mr. BAIN. I don't think there is any question about that, Senator. If IBM indicated that in their business judgment, this was a business they wanted to be in, they were going to stand behind it financially, that would certainly settle a lot of investor anxiety about MCI's ability to compete.

Mr. MORRIS. I do not think the association as it currently stands, by definition, means that you have a stronger competitor. I think, if you look at the performance of the stock, the stocks that you referred to, there are a couple of things reflected.

One, there was a change in the ground rules so you can see the stocks perform fairly well and then decline precipitously. Second, as you view MCI, you can see most recently a slight improvement in its stock, the expectation that perhaps this association will allow it, one, a source of capital; and two, the ability to in fact compete more aggressively against AT&T. But by definition, I do not think that the association requires that.

Senator GOLDWATER. Thank you.

Do you believe the market is competitive?

Mr. MORRIS. Yes.

Mr. BAIN. The market for interexchange services?

Senator GOLDWATER. Yes.

Mr. BAIN. Well, certainly it can be.

Senator GOLDWATER. Well, is it?

Mr. BAIN. No, sir. I would have to say today we are working toward it. It is difficult to describe the entire nationwide market as being competitive, when AT&T still has the dominant market share. But there are some routes, routes serving the cities, for example, the Chicago to New York route, the eastern corridor, in which there appears to be rapidly developing competitive alternatives.

So in certain of the markets, yes, I believe it is today competitive and can be. The technology is good. Demand is strong and growing. There is no inherent reason why this industry cannot support more than one nationwide carrier. We are already seeing it on select routes.

I think, given a chance over time, we will see that competition brought to the great bulk of the populace.

Senator GOLDWATER. Well, if it is competitive, wouldn't it follow that it is about time that the FCC makes its move?

Mr. MORRIS. I should follow up on my response to you when I said yes, it is competitive. I think in selected market segments, there is competition. That competition is attempting to grow.

Senator GOLDWATER. When you say a selective market, what is selective?

Mr. MORRIS. Segments. For example, there is an attempt, a growing attempt, to compete, for example, on the Washington to New York route or the New York to San Francisco route or the New York to Chicago route. I say there is an attempt to compete. As I mentioned earlier in my prepared comments, the basis of competition right now for those other common carriers is price, because that is essentially the only product that they have available to them.

Senator GOLDWATER. I just want to make a comment. I am just making this as one individual.

If the divestiture of AT&T was a good thing, and I don't happen to think it was, but let's say it was, and when everybody looked forward to the possibility of decrease in telephone prices, why in the hell am I paying \$30 a month when I used to pay \$4? Is that competition?

Mr. MORRIS. I cannot touch your phone bill. I do not know. The other aspect of competition, though, is choice.

Senator GOLDWATER. Well, if it is competition, it is something I never learned in my business life. If you have competition, prices came down. And not only are we seeing prices going up; we are getting, in some places in this country, downright rotten service. In some places in this country it is better.

I just want to make that comment. I would like to even have AT&T tell me why my prices have gone up so doggoned much. I know I have grandchildren that bug that phone all the time, but you can't bug it that much.

Do you think that deregulating AT&T too quickly will interfere with competition?

Mr. MORRIS. When you say "too quickly," I guess that, by definition, would imply that it would interfere.

Mr. BAIN. Senator, I really think that AT&T is serious about wanting to build some major new businesses outside of their traditional regulated long-distance service. They don't do that by becoming cut-throat competition and destroying the profit margins in the industry.

I think all else being equal, AT&T would truly like to see a level playing field and a pricing structure that enables them to earn a reasonable return.

If they are deregulated, the traditional fear has been that their returns would go up, not down. I don't believe that it is in the industry's interest or in that of AT&T itself to become market-share hungry and competitive to the extent that they ruin their own profitability. I believe investors would react negatively to that, and it would impair their ability to build what really have got to be billion-dollar businesses outside the regulated industry, if it is to benefit their investors and bring the investors the benefits of that divestiture.

Senator GOLDWATER. Well, the big argument for divestiture and the big reason for the lawsuit was to destroy a monopoly and bring prices down, and yet that hasn't happened. I think Judge Greene must turn over in his sleep every night and have nightmares.

I have a few more questions that I will submit for your answers because time is getting short, and we do have some other people showing up. I have three questions, and you can answer them.

I want to thank you both for being here. I don't believe I have ever heard analysts testify before a committee of the Congress and one who was not confusing. It is a little difficult to understand.

Mr. BAIN. Our customers say that also.

Senator GOLDWATER. I didn't listen to E.F. Hutton.

The next witness will be Mr. Gene Kimmelman, legislative director, the Consumer Federation of America. Mr. Kimmelman, you may be seated, and go ahead as you desire.

**STATEMENT OF GENE KIMMELMAN, LEGISLATIVE DIRECTOR,
CONSUMER FEDERATION OF AMERICA**

Mr. KIMMELMAN. Thank you, Mr. Chairman.

My name is Gene Kimmelman and I am legislative director of the Consumer Federation of America. I have a written statement that I would like to submit for the official record.

Senator GOLDWATER. You may do that.

Mr. KIMMELMAN. I would like to begin my comments this morning by agreeing with something Mr. Bain said a few moments ago, and that is that there is no free lunch in this business. Certainly from the industry perspective that we have heard so far this morning—both investors and the participants in the telecommunications industry—someone has to win and someone has to lose.

But I am here representing the interests of the American consumer. And the question for the consumer is, Is there even lunch? And if local phone service is the equivalent of breakfast, the question is whether consumers can afford to eat breakfast at this point.

From our perspective, the telephone system right now is really a mess, and I would like to walk through with you just what consumers face right now in this whole issue of long-distance competition.

First of all, people are worried. Is even basic phone service going to be affordable down the road? In the first year after the divestiture we have seen over \$2 billion in local rate increase, about \$2 a month for every consumer.

Senator GOLDWATER. What was that figure again?

Mr. KIMMELMAN. \$2 billion, about \$2 a month in everyone's local phone bill, on the average.

Senator GOLDWATER. The \$2 million, is that nationally?

Mr. KIMMELMAN. Yes, \$2 billion.

Senator GOLDWATER. \$2 billion?

Mr. KIMMELMAN. \$2 billion.

Senator GOLDWATER. Oh, I thought you said million, and I was confused. Thank you.

Mr. KIMMELMAN. No, \$2 billion.

In addition, we have seen an access charge added this June to local bills, now called a subscriber line charge, worth about \$1 billion. That is \$1 a month on everybody's phone bill. And installation charges on the average have been going up about 27 percent.

In addition, people are really confused. What has been described this morning from the industry perspective as transition, for the consumer is like a revolution. You have gone from one-stop shopping from one telephone company, to a total segmentation. You have to get installation. You have to get local service. Sometimes there is a usage charge. You have to buy or lease your phone,

insure your wire or don't insure your wire. Repairs. It is a total mess.

And then we get to picking a long-distance company, which is even more confusing right now. How do you do it? First of all, companies have different initial fees, or no initial fee, minimum charge. Some have different distance bands. Some have different time-of-day discounts. Some have total-cost discounts. Some have discounts if you just talk during a certain period of the day. How do you compare them?

And of course, the services are different. Can you call anywhere? Not on all the long-distance phone companies. Can you get operator service? Is the quality of transmission the same? No; it is not. Are you going to get accurate billing? Not always.

Well, what does all this mean? Instead of getting the benefits promised by the breakup, consumers are getting local rate increases that may threaten the affordability of service, particularly for lower income people, and they are getting a confusing long-distance system where many don't have any competitive choices right now. Some may never get any. And those who have them can't figure out how to save money or whether there is a way of saving money.

Why is this so? Many people are pointing the finger at competition in general and certainly the breakup of the Bell System in particular for these problems.

I would like to go out on a limb here this morning and disagree with that. I do not think it is either competition or the breakup that created this current mess that we are in. I think it is the wrong regulatory policies that are failing to guide the profit-maximizing activities of phone companies toward more competitive benefits for most of the American people.

Now, how is this so? Well, the FCC seems to think that it is in the business of deregulating for the sake of deregulation itself, rather than to foster competition. There are a number of problems with that. The FCC seems to be confusing two very different things. A market where competition is slowly emerging like the telephone market, is being confused with a market that is already fully competitive. This is really a crucial problem in the telephone business because of the peculiarities of the telephone network itself.

First of all, parts of the market just are not, and probably will not become, competitive. For example, local service; most people only have one local phone company and probably always will. Rural service may not be competitive. Low-volume, long-distance usage may not be competitive. And there are others.

Second, so much of the network equipment in place is used for all different kinds of calling: local calling, long-distance calling. When you pick up your phone and place a local call, put it down, pick it up and place a long-distance call, you are using a lot of the same equipment, or when you place long-distance calls to two different places, a lot of the same equipment. So you have a problem in cost allocation when the equipment is used for so many purposes.

Now, without regulation, given this equipment scenario, a profit-maximizing firm has an incentive to shift the costs to the least

competitive services. That means shifting costs to local service, service rural customers receive, to short-haul, long-distance service, and instate long distance service. The result of that is higher prices for the people who have no alternatives and the potential of driving small companies out of business.

So we need continued regulation of AT&T to spread those jointly used equipment costs fairly so everybody who uses the system pays for it, and to ensure that competition spreads from lucrative, big-business, high-volume usage markets to reach all consumers.

An example of the immediate need for regulatory intervention is the equal access process. We have equal access going into most of the communities in this country in a piecemeal fashion—that means not the entire community at one time—it means part of a neighborhood at a time. It may mean one side of the street but not the other side of the street because of the peculiarities of the telephone network.

What does that mean for the consumer? Well, when you cannot figure out from what the companies are offering how you save money, you need more information. But nobody can mass market advertise in this kind of a situation because one person is getting equal access, another person is not. Is a newspaper going to write a long, explanatory story about all the intricacies of equal access? Probably not until most people in that market are getting it. The same for television, the same for radio.

Something has got to be done about this. From the consumer's point of view, I think it appears that a little bit of regulation now may help competition to grow and help spread the benefits of competition equitably, thus cleaning up this current mess, and more importantly, preventing the need for massive Federal intervention to reregulate this industry down the road.

We think it is time for Congress to evaluate what the FCC has been doing and impress upon that agency the need to make sure that competition is enhanced, not thwarted, and that the fruits of competition reach all the American people. Otherwise, the Bell System breakup will not have been worth it for the American consumer.

Thank you.

Senator GOLDWATER. Thank you very much, Mr. Kimmelman.

Mr. Chairman, do you have questions?

The CHAIRMAN. I do not, Mr. Chairman.

Thank you very much, Mr. Kimmelman. I appreciate your testimony.

Senator GOLDWATER. I have just a few.

You say that the FCC policies have exacerbated consumer concerns. How do you think the Commission can help the consumer?

Mr. KIMMELMAN. Well, for example, in this equal access process, we are in a situation where people just do not know what to do, how do you pick a long distance company? If it were being done community by community, you would have the benefit of our best information tools out there: mass media advertising, and mass media information provided by your local newspaper, radio, and television stations.

Right now consumers are not getting that. We are running a service that is being supported by the telephone companies, a free

hotline number, providing people the opportunity to call and ask about equal access. We are getting thousands of calls a week because people do not understand what is going on. There has got to be a better way of getting that information out to the public, to make an informed choice.

Senator GOLDWATER. I would agree with that last statement. I am wondering, though, if the FCC is the sole, would be the sole source of that information.

I get this all the time.

Mr. KIMMELMAN. Senator, I do not think they need to be. I think the FCC needs to make equal access rules that give everybody an incentive to do as much informing of the public as possible. Right now it is a dangerous situation. If I were a long distance phone company, I would worry about placing a full page ad in a newspaper because one customer may be able to get equal access from me, but another one may not, and that customer who cannot get it but wants it is probably going to be mad at me. My advertisement will not work.

So I think there have to be ways for the FCC—not to provide the information directly, they are not in the business of doing that—to set rules so that everyone has an incentive to provide that information in the best manner possible.

Senator GOLDWATER. Well, from your correspondence—and you must have a lot of it—do you think consumers are aware of what is happening in the long-distance market and are aware of what is happening with long distance rates?

Mr. KIMMELMAN. Consumers are worried that they have gone through this entire mess, this entire change of a phone system that they thought was pretty good in the first place, for the purpose of getting tremendous new products and cheaper long distance service, and they are afraid they are not going to be getting that, and they are afraid of it for a number of reasons. First because local rates are going up, and also because consumers do not see those great price decreases in long distance service that were promised.

Most consumers do not do a lot of long distance calling. They may be able to save a penny or two here, but the big breaks in prices are for the big users—mainly big business.

So I think a lot of consumers are real worried that they are not getting what they were supposed to get from the breakup.

Senator GOLDWATER. Well, do you think that competition in the long-distance market today is adequate to protect consumers without regulating AT&T rates?

Mr. KIMMELMAN. Absolutely not. We have got all this equipment that is used for so many purposes, local calls, long distance calls, different kinds of long distance calls. There is no one way of pricing that. If you have no regulation, the incentive is to shift the costs onto the services that are least competitive, onto the consumers who have no alternatives. That is going to hurt. You need regulation to make sure that there is an appropriate splitting of these costs, make sure that everybody who uses that equipment, who gets service from the phone company, whatever kind it is, pays their fair share for that service.

Senator GOLDWATER. And this would apply to all the companies, too.

Mr. KIMMELMAN. Well, I think what it really applies to is AT&T because they have this entire network out there. The other long distance companies do not have that network, they are coming in piecemeal rather than coming from one huge system, and they do not create the same problems with jointly used equipment.

Senator GOLDWATER. Do you believe that a shift of costs from business customers to residential customers is occurring or will occur?

Mr. KIMMELMAN. I believe we are seeing a little bit of it. Regulators are out there trying to deal with the rate requests at the State level, and they are having a hard time. In some States you have still got \$7 or \$8 a month phone service. Other states you are already up to \$18, \$19, \$20. So there is obviously a variation in how the regulators are dealing with it, but there are clear incentives of trying to reduce the prices to business customers which is, everyone acknowledges, the most lucrative market. That is the way to make the most money in this business.

And if you are reducing prices for them, you have to get your costs covered somewhere else. So we are very fearful that there is a real tendency towards shifting those costs onto the residential customer.

Senator GOLDWATER. I want to thank you for your presentation, but I just want to say that right at this moment I do not think I see even a light at the end of the tunnel. I often wonder what would happen if AT&T someday said oh, to hell with it, and blew up that whole switchboard up in northern New Jersey.

Now, I am serious about that because it is without a doubt the world's most complete, finest communications system that has ever been put together, and I do not know how these other companies can expect to compete when that great big blackboard up there is controlled by one company.

I know what the original intent of the lawsuit was. I think if they ever carried that through to its final conclusion, we would be looking at maybe \$500 million or \$600 million for legal costs, and then God knows what the telephone costs would have been.

I want to thank you, and I hope you will make more inquiries in depth from your subscribers because if we are going to get at this thing, some way, some place we are going to have a little hidden rug we look under, and we will find it.

Do you have any questions for this gentleman?

Senator GORE. Yes, sir, just a few brief ones.

I read your statement very carefully and have enjoyed working with your organization on many occasions.

Back when the telephone company was all together, were you not all in favor of breaking it up?

Mr. KIMMELMAN. Senator Gore, we were in favor of doing something about what we thought were the antitrust violations that were taking place at that time, and so we were supportive of seeing Congress get involved to see what needed to be done, and certainly of having the courts oversee this problem.

We in no way subscribed to the actual breakup that occurred and raised many concerns about how it occurred.

Senator GORE. I did not want to ask an unfair question, but I did have some faint recollection of that.

Would you do it again, knowing what you do now?

Mr. KIMMELMAN. I think that there is a lot to be gained from competition in this market, and I think there are better ways of doing it than the way we did it. So I think, with a little trepidation, if there were someone who was a czar and could take care of all these things at one time, that yes, you could do it and you could come out with a very good, increasingly competitive market with affordable phone service for everybody.

That is not what has happened, and the problem I have right now is figuring out what we need to do to fix that.

Senator GORE. Well, in fairness, there really is not any inconsistency in the position you have taken because you have just testified here that FCC policies are, in your view, the real reason why we have confusion and higher rates and unequal benefits among consumers.

One of those FCC policy decisions was to shift a substantial part of NTS costs from long-distance carriers to local customers in the form of end user charges.

What is your opinion of that decision?

Mr. KIMMELMAN. I think that decision went way too far in terms of shifting costs. I think there might be a problem in what is going on in pricing in the long-distance market today. There certainly are a lot of new technologies, a lot of new developments. But that way of shifting billions of dollars from long distance onto local rates was totally inappropriate and did not even serve the purpose that the FCC intended.

Senator GORE. Well, I certainly agree with that.

The FCC now says it intends to study the situation for 2 years or after 2 years before it decides whether or not to raise the access charge to \$4, \$5, or \$6 or whatever.

Do you have confidence in the Commission to adequately study the problems of local customers before it raises access charges? I mean, after all, they originally talked about a \$4, \$5, \$6 per month charge as being in the consumer's best interests.

Mr. KIMMELMAN. Well, I have more confidence now than I had a couple years ago. It appears that after having seen the response of the Congress to that decision, that the FCC is looking at it a little bit more carefully.

I am still concerned that the FCC does not have enough data on what is happening out there to ratepayers. They are considering a Lifeline proposal to take care of low-income people, and they do not even have the data on how many people have or do not have a telephone in this country or what rate increases have done to change that situation.

So I have got grave concerns that they are heading down a policy course where somehow deregulation has become a goal in and of itself rather than a means toward an end. We need to slow that process down, and we need to gather the data to find out what the implications of these policies are before we are stuck with fewer people with a telephone.

Senator GORE. I made a statement in questioning the two people on the last panel about the FCC's gathering of data.

I take it you agree with me that they need much more data about what the true cost of service is and where the cross subsidies are and the like.

Is it realistic to expect they can get that data? You know the history of the accounting procedures inside AT&T and how Byzantine these data flows are. Is it realistic to expect that they can get this data?

Mr. KIMMELMAN. I think it probably is not realistic to expect that, and in many respects it is not their fault that they do not have it. This is very complicated. But what is their fault right now is they are moving toward policies that require having that data, and they are not going to have it. They are moving towards changes in policies that require very accurate bookkeeping and accounting that we are not going to get. And so that is the danger in what the FCC is doing. It is off course in its policies.

The data collection will always be a problem, and therefore, what we need is a regulatory structure where it is less important to have that data and rely on other mechanisms to ensure that we foster increased competition and the right allocation of costs to the consumer.

Senator GORE. Now, briefly, on the subject that we are primarily focusing on here today, you believe that the FCC should slow down the pace of the movement toward full charges for the OCC's, is that basically what you are saying?

Mr. KIMMELMAN. I think that might be one element. It has been asked this morning, what do we want the FCC to do. Really, the answer is to do something because in a lot of areas the agency is not doing anything. We have equal access taking place in many different ways in each part of the country. There are no precise rules. In some places it is taking place fine. In others it is not so fine. Some places people are getting the same quality service with OCC's as AT&T, and they should be paying the full price. In other areas that is not occurring.

And so what we need is guidelines, some rules from the FCC to make this system fair. That is what we do not have.

Senator GORE. One final question.

I get as many complaints from my constituents about the billing as anything else. People are really fed up with getting all these separate bills coming in covering everything.

Has your organization studied any possible ways to deal with that? Even if you have separate market places for these different aspects of the service, is there any feasible way to consolidate the end payment for the customers so that they get the information needed on which to base choices between competitors but at the same time they have the convenience of being able to pay it all at once? Maybe that is unrealistic, but have you looked at that?

Mr. KIMMELMAN. Yes, Senator, we have looked at it because we get complaints about that all the time, but unless we want to move toward a system where there is one billing agency, which I would suggest may be dangerous, we have a problem here. I do not think it takes a lot of thought to realize that you certainly can reduce the number of pieces of paper; take 1 piece of paper and fold it up and put it in the envelope rather than have 10 or 15 and forget which page is which.

So there are certainly some things you can do which have not been done yet in the telephone business.

Senator GORE. So our solution lies with origami. I am not sure that will satisfy many of the people who have complained, but anyway, I am interested in looking further into that, seriously. It may be an impossible problem. The solution may be impossible, but we sure do get an awful lot of complaints about that.

I appreciate your statement here today.

Mr. KIMMELMAN. Thank you, Senator.

Senator GOLDWATER. Thank you very much.

[The statement follows:]

STATEMENT OF GENE KIMMELMAN, LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA

The Bell system breakup was supposed to produce consumer benefits through increased competition. Instead, local rate increases threaten the affordability of basic phone service and federal regulatory policies threaten to deny residential consumers the benefits of long distance competition. A little regulation now may prevent the kind of confusion and rate discrimination that would spur considerable regulation down the road.

I. LOCAL RATE INCREASES

Nearly two years after the divestiture of American Telephone and Telegraph (AT&T), consumers remain confused and frightened about the state of our telephone system. What was once one-stop shopping for telephone service has become a consumer nightmare. The local service charge, which used to reflect the entire cost of service, is now only a portion of that cost. Consumers must now buy or rent a phone, purchase their inside wiring, pay to insure the wiring (or pay to repair it later), and in some cases pay usage charges for local calls, in addition to the basic service charge. Similarly, installation and repair charges, now divided into separate fees for office work, line connection and labor, have risen dramatically.

Consumers have been bombarded with rate increases and new telephone charges that threaten the availability of affordable phone service for all Americans. From the announcement of the Bell breakup to its first anniversary, local phone companies asked for \$10.9 billion, and received \$5.1 billion in revenue increases.¹

Since the AT&T divestiture, the price of the major components of basic phone service has risen significantly. The average cost of flat rate, unlimited use service rose from \$10.5/month in 1983, to \$12.44/month in 1984, including the maintenance of telephone wiring in the residence (inside wiring) and the increased rental cost of a telephone (see Appendix A,² pp. A-7 to A-16).³ This increase in residential flat rate service equals \$1.99/month, a 19 percent rise.

Similarly, the cost of measured service has risen from \$5.11/month in 1983, to \$6.57/month in 1984. This increase in residential measured rate service equals \$1.46/month, a 26 percent rise. The average per-call charge for measured service, \$.08/call, has not changed since divestiture (see Appendix A, p. A-10).

A. Installation and Repair Charges

Another significant post-divestiture rate increase involves installation and repair charges. Many labor costs, which used to be part of the basic installation and service package, have been separated and priced at as high as a \$160/hour rate.⁴ In addition, the cost of the most simple installation job—requiring no service visit, rewiring, etc.—has risen on average from \$31.23 in 1983, to \$39.67 in 1984 (see Appendix

¹ Report of the Staff of the Committee on Energy and Commerce of the U.S. House of Representatives on Local Telephone Rate Increases, January 1984, at 2; Summary of State Telephone Rate Cases, Industry Analysis Division of the FCC, October 31, 1984 at 2.

² The appendices have been retained in the Committee files.

³ Many services, like local directory assistance, that used to be provided as part of this basic local service package are now priced separately. Unfortunately, we were unable to find data showing either the value of these services or the amount by which local rates should have declined when phone companies established separate charges for these services.

⁴ Telephone survey of rates, installation and repair charges in 27 states conducted by CFA staff, November 15–December 14, 1984.

A, pp. A-11 to A-12). The average cost of telephone installation is now \$47.60, as compared to \$34.48 last year, a 27 percent price increase (see Appendix A, p. A-12).

B. Access Charges

On top of local residential rate increases, federal and state regulators have decided to add at least \$2 billion in new local "subscriber line charges"—formerly called access charges.⁵ Beginning this June, all residential customers, regardless of whether they make long distance calls, started paying a \$1/month interstate access charge for equipment costs formerly charged to interstate long distance users. In 1986, this charge will rise to \$2/month, and at that point, the Federal Communications Commission (FCC) will decide whether the access charge should continue to rise. Previously, the Commission determined that consumers will benefit most if the access charge is increased to \$7/month.⁶

The access charge decision includes a \$.35/month surcharge that may be added to all charges by state regulators in 1985 or 1986. This surcharge is intended to replace a revenue decrease caused by rate reductions offered to large-volume users—generally big business—who threaten to leave the public network.

In addition, the states are likely to increase local rates to parallel the FCC's interstate access charge. Unless by the end of 1986 the states add \$2/month to residential phone bills, intrastate long distance rates will be significantly higher than interstate long distance rates. Such a rate disparity would lead many long distance carriers to route in-state long distance calls inefficiently, through interstate lines, to offer cheaper long distance rates. So, either through an intrastate access charge or local rate increases, consumers are likely to face \$2 billion worth of state-imposed local charges to match the federally mandated access charge.

C. Drop-off

Post-divestiture residential installation charges and local rate increases may force over 4 million people to do without a telephone (see Appendix A, p. A-24). Based on a computer model devised by Lewis Perl of the National Economic Research Associates for the Central Services Organization of the Bell Operating Companies in 1983, the \$2.0-2.5 billion worth of 1984 rate increases cited above may already have lowered the percentage of households on the public telephone network by 1.7 percent (see Appendix A, p. A-22). If pending residential rate requests reflect a national trend (see Appendix A, p. A-16), and like last year, 47% are granted in 1985, an additional 1.5 million people may be forced to do without a phone by December 1986 (see Appendix A, p. A-24). This means that post-divestiture residential rate hikes may force 6 million people to do without a phone by the end of 1986 (see Appendix A, p. A-24).

D. Lifeline

Recent and pending local rate hikes make it essential that a simple, cheap "lifeline" service be offered to the millions of people who will otherwise go without a phone. In an ongoing proceeding before the FCC, we have recommended that the Commission establish a Lifeline Service Fund to make basic phone service affordable for all Americans (see Appendix B, Lifeline Proposal).

II. LONG DISTANCE COMPETITION OR REMONOPOLIZATION

Despite the dangerous trend toward significant local rate increases, many deregulation proponents argue that the benefits of long distance and equipment industry competition outweigh the post-divestiture burdens shouldered by consumers. They claim that further long distance deregulation will foster continued long distance rate reductions.

While there is no doubt that consumers have benefited from competition in the equipment and long distance markets, it is unclear whether these benefits will continue or be equitably distributed if the long distance market is deregulated. Without appropriate regulation, AT&T could use its market power—control of almost 90 percent of the long distance market outside local phone company calling areas⁷—to un-

⁵ *In the Matter of MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, CC Dockets No. 78-72 and 80-286, adopted December 19, 1984, released December 28, 1984.

⁶ *MTS and WATS Market Structure*, CC Docket No. 78-72, Phase I, Third Report and Order, 48 Fed. Reg. 10319 (March 11, 1983), modified under reconsideration, July 27, 1983.

⁷ "Did it Make Sense to Break Up AT&T?" *Business Week*, December 3, 1984, at 92.

derprice competitors in the most lucrative markets and thereby drive them out of business. For long distance competition to grow and flourish in less lucrative markets—like for the almost 75 percent of residential consumers who make few long distance calls per month⁸—a reasonable number of challengers to AT&T must become firmly established in the long distance market.

A. The Transition to Competition

It is often forgotten that a market with emerging competition is not the same as a competitive market. The lawsuit that led to the Bell breakup was initiated because the government believed AT&T was thwarting the growth of competition, not because the telecommunications market was already competitive.

So far, the growth of long distance competition has benefited a small segment of the population. Only the business and residential customers who make a considerable number of long distance calls have saved much money by shopping around for long distance service. All long distance carriers—whether seeking to preserve market dominance, like AT&T, or trying to break into the market, like the other common carriers—have aimed their marketing at big business customers, because the companies stand to gain the most by competing for the largest volume users of long distance service.

The public at large may only benefit from long distance competition if the most lucrative long distance business is divided among a sizable number of firms. If only one or two firms survive, they are most likely to focus their price-cutting attention on the most profitable market—the 10 percent of business users that generate 75 percent of long distance revenue.⁹ If a larger number of carriers survive in the long distance market, and the most profitable business is broadly dispersed, carriers are more likely to vie aggressively for the business of low volume users—both business and residential.

While it would be inappropriate for federal regulators to seek specific market allocations, it would serve consumers' interest for the FCC to preserve an environment that, at least in the short term, fosters the growth of AT&T's competitors.¹⁰ Unless a number of small long distance carriers survive, consumers are likely to be saddled with the costs of deregulation—substantial local rate hikes, confusion and complexity—without receiving the fruits of long distance competition.

The fact that continued regulatory promotion of competition may diminish AT&T's share of the long distance market should be of little public concern. After all, a necessary condition of the change from monopoly to competition is that the monopolist, AT&T, losses some of its market to competitors. In addition, the divestiture agreement enabled AT&T to enter the computer business by releasing the company from the conditions of a 1956 consent decree.¹¹ So even though AT&T may lose a portion of its long distance business, it stands to enhance its financial strength by expanding into the unregulated computer market.

B. Equal Access

Rather than promote competition, the FCC's equal access policies have stunted its growth. Most consumers, unaccustomed to choosing long distance service, need extensive information on how to shop around for the long distance service that meets their needs. Yet the FCC has allowed local phone companies to implement equal access—equipment changes designed to make the local service connections of all long distance carriers equal in quality at AT&T's service connections—in a manner that limits information dissemination to the public.

By implementing equal access in a piecemeal fashion—bits and pieces of each community at a time (i.e., end office cut-overs) local newspapers, television and radio stations have no incentive to help consumers make an informed equal access choice until it is too late; only when most of the local audience has received equal access, and therefore already chosen a long distance carrier, does it make sense for local media to provide detailed reporting on the equal access process. Similarly, the

⁸ See the Wall Street Journal, April 2, 1984.

⁹ Comments of Bell System Operating Companies and AT&T In Response to the Fourth Supplemental Notice of Inquiry and Proposed Rulemaking, *In the Matter of MTS and WATS Market Structure*, CC Docket No. 78-72, Phase I, August 6, 1982 at 92.

¹⁰ We applaud the Commission for its recent decision to allocate default traffic—users who fail to choose a primary long distance carrier during the equal access process—among long distance carriers. This decision should give consumers an incentive to shop for long distance service as they do for other products in competitive markets.

¹¹ *United States v. AT&T Co.*, 569 552 F. Supp. 131 (D.D.C. 1982) and *United States v. Western Electric*, 569 F. Supp. 990 & 1057 (D.D.C. 1983).

long distance carriers have refrained from mass media equal access advertising, out of fear that many consumers will fail to understand when equal access occurs; one side of a street may not get equal access until a year after the other side.

Without the benefits of efficient information dissemination, consumers have great difficulty making a cost-saving long distance choice. All the long distance carriers offer such complicated rate structures that it is virtually impossible for even the most informed consumer to select the optimal service option: some require a minimum monthly fee, some have low rates to one region but high rates to another, some have different time-of-day discounts and some have high-volume discounts. Also, the carriers' direct mail advertising probably confuses more consumers than it helps; our organization has been bombarded by consumer questions that indicate considerable misunderstanding of the equal access process—like whether one can switch long distance service after choosing a primary carrier, receive service from numerous carriers, or reach an AT&T operator without selecting AT&T as a primary carrier.

It should come as no surprise that the natural response to such complexity and confusion is for consumers to stick with the long distance service they already have—most likely AT&T. While this may be the best choice for many consumers, the FCC should be concerned that confusion rather than adequate information is guiding consumer choice in the equal access process. Consumers are unlikely to make market choices necessary to limit their costs, and small long distance carriers are unlikely to survive, if consumers decisions remain grounded in despair rather than adequate information.

C. Longrun Outlook

If the seeds of long distance competition are not destroyed by premature deregulation, the long run likelihood of full-scale competition depends on careful FCC oversight of the long distance market. For the foreseeable future, regulation will remain necessary because of two inherent attributes of the telecommunications market: particular submarkets—like residential local service and long distance in remote areas—will remain monopolistic, and a considerable amount of telephone network equipment is used to provide both monopoly and competitive services.

Without regulation, the one long distance company that serves both competitive and monopolistic markets—AT&T—has an incentive to maximize profits by shifting costs from its most competitive to its least competitive services. This means that low volume long distance users, residential and business customers who make short-haul long distance calls, and residents of rural areas would be unlikely to receive long distance rate reductions, if AT&T were deregulated.

In addition, the entire telecommunications industry has an incentive to shift costs into the most monopolistic market—local service—so each carrier can reduce prices for increasingly competitive services and thereby spur demand for new uses of the telecommunications system. With so much equipment—\$30-40 billion worth—jointly used for both local and long distance calling, regulation is necessary to prevent overburdening local ratepayers with costs that should be spread among all users.

Unless competition expands to the point where monopoly submarkets disappear, regulation will be necessary to prevent price discrimination. While consumers are willing to pay their fair share for both local and long distance service, they should not be required to subsidize competition for services they do not use. Until competition expands and flourishes in the markets where network equipment is shared, consumers can only rely on regulation to protect them from shouldering an inordinate share of network costs.

CONCLUSION

Unless federal policy ensures that universal phone service is preserved and the fruits of competition are available to all Americans, consumers will oppose further deregulation of our telecommunications system. Consumers question government policies that create confusion, complexity and local rate increases for residential customers yet enable large users—mainly big business—to reap the price reduction benefits of the post-divestiture, deregulatory environment. The FCC must intervene in the equal access process and maintain regulation of AT&T to give competition the opportunity to expand throughout the long distance market.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR GOLDWATER AND THE ANSWERS

Question. I think it is important that all Americans, not just those who live in big cities, or use a lot of long distance, see some benefits from the divestiture. What can be done to ensure that competitive long distance service options are available in rural America?

Answer. We need a slow transition from monopoly to competition with careful regulatory oversight by the FCC to ensure that all consumers benefit from the divestiture. It is often forgotten that a market with emerging competition is not the same as a competitive market. Regulation will be necessary for the foreseeable future to ensure that the seeds of competition develop into a competitive marketplace.

So far, the growth of long distance competition has benefited a small segment of the population. All long distance carriers have aimed their marketing at big business and high-volume residential customers in densely populated areas, because the companies stand to gain the most by competing for the largest volume users of long distance service.

Rural America may only benefit from long distance competition if the FCC establishes rules that help disperse the traffic of large volume users among a large number of long distance companies. If only one or two firms survive, they are most likely to focus their price-cutting attention on everything but the rural market. On the other hand, if a larger number of carriers survive in the long distance market, they are more likely to vie aggressively for the business of low volume users. Therefore, the FCC's equal access rules should err on the side of protecting small long distance carriers, rather than AT&T, to increase the likelihood of long distance competition expanding into rural areas.

Question. What do you think is happening to the average long distance customer's rates?

Answer. The average long distance customer has saved 5-10% from AT&T in the last 2 years, and the rates of the other long distance carriers have remained slightly lower than AT&T's rates. Unfortunately this amounts to very small savings for the average consumer, who makes less than \$10/month in long distance calls. In addition, local rate increases have more than wiped out these savings for most consumers.

Question. Is the FCC deregulating AT&T too quickly?

Answer. The FCC has been inconsistent in its treatment of AT&T. It has accepted some tariffs without adequate cost justification while rejecting others. We believe the Commission must carefully scrutinize the cost justification of AT&T's tariffs before accepting them, and maintain regulation of AT&T to give long distance competition an opportunity to develop into a fully competitive marketplace.

Senator GOLDWATER. Our next and last witness will be Mr. James Irvine, vice president, AT&T Communications Workers of America.

Mr. Irvine?

**STATEMENT OF JAMES E. IRVINE, VICE PRESIDENT,
COMMUNICATIONS WORKERS OF AMERICA**

Mr. IRVINE. Thank you, Mr. Chairman, and just for the record, let me get that title straight. That is vice president, Communications Workers of America, with responsibilities for dealing with the AT&T Communications Co.

Now that we have had 20 months of postdivestiture life, it is appropriate for this committee to look at the domestic telecommunications industry and what Government has done to it. Only 2 weeks ago AT&T announced a cutback of 24,000 jobs, and we are fearful there are more to come. These CWA members are your constituents.

We are all hearing complaints about ever-rising telephone bills, about customer confusion and about deterioration of services. Divestiture, deregulation and a mindless attitude of free trade have led to this damage of a key U.S. industry. We have urged the FCC

not to back away from its intention to require equality of access charge payment when an exchange is converted to equal access. To fail here would be discriminatory, a violation of the Communications Act.

The time has come for the OCC's to cease the endless legal struggles and instead concentrate on the marketplace. The OCC's freely entered the competitive fray and are now seeking further shelter from AT&T which they somehow try to portray as the monopoly of some 15 years ago.

This monopoly no longer exists. Judge Harold Greene cited the local exchange "bottleneck" as a major factor which could hamper full competition in the long-distance market. Divestiture removed that "bottleneck," he noted.

CWA also is gravely concerned about the mindless "free trade" attitude, which has led to foreign products taking 14 percent of the U.S. market in 1984, in part due to divestiture.

Long-distance competition issues now are centered around equal access, the factor making each competing carrier as easily reached as all the others. The OCC's for many years complained about not having equal access, or as it was once labeled, dialing parity. One key aspect of the AT&T consent settlement was that the BOC's, by September 1986, are to have most of the lines of their 9,200 class V end offices converted to 1 plus dialing so all competitors will compete on the same terms. Most of the Nation will have been converted to "equal access"; when the conversion occurs, all toll carriers must in all fairness pay the same network access charges to the exchange carriers.

The competitors of AT&T are now telling a sob story about the hardships of life in the competitive world. They have importuned this committee to convene these hearings so that they can complain about imaginary ills. The key issue is this: while the OCC's are getting the equal access that they have been demanding, they do not want to pay for the upgraded exchange access because then their competitive edge or their competitive margin versus AT&T will be disappear.

The committee should note that the OCC's are dragging a non-issue into these proceedings. They claim the local exchange access they receive is somehow not really equal to that provided AT&T. However, the OCC's in their printed and broadcast advertisements make the point that their circuit quality and dialing ease are exactly the same as AT&T's.

This committee and the FCC appear to be receiving a contradictory story which the OCC's must explain.

A large part of the 24,000 job reduction in AT&T Information Systems will result from imports of telecommunications equipment which should exceed some \$2.5 billion this year. We want to stress to the Congress that imports of telecommunications equipment rose sharply from 2 percent of the market in 1982 to 14 percent in 1984. We support a strengthened version of Chairman Danforth's bill, S. 942, which would inject a strong dose of fairness into the telecommunications equipment market.

We are aware that the administration opposes new legislation and has given some ethereal indications it will somehow get tough in enforcing the present laws. We predict the administration will

forget any such intention as soon as the Congress recesses in late 1985. Other matters will become administration priorities.

We are supporting trade reform legislation to establish a national trade policy. Currently a President is entirely free to ignore the economic realities facing American industries, and for his own reasons to allow them to be overcome by imports.

We have already seen the devastation of auto, steel, textiles, shoes, marine tools, and shipbuilding. We must prevent the loss of the telecommunications equipment industry.

Thank you.

Senator GOLDWATER. Thank you very, very much.

Do you have some questions?

Senator GORE. You go ahead, Mr. Chairman.

Senator GOLDWATER. I do not have many.

AT&T has just announced, as you said, cutbacks of 24,000 jobs, and my understanding is that AT&T is closing shop on equipment manufacturers and moving production to Singapore and other places.

Is that true?

Mr. IRVINE. The Shreveport manufacturing plant which produces the last American made telephones, is going to be moving to Singapore, that is correct.

Senator GOLDWATER. Moving it over to Singapore.

Mr. IRVINE. That is correct.

Senator GOLDWATER. Let me ask you, are other electronic manufacturers not doing the same thing?

Mr. IRVINE. Absolutely, and we see this as a critical problem over the next few years. We see the burgeoning of the imbalance of trade as severe.

Senator GOLDWATER. I think it is 70 percent of all electronic equipment used in this country is made either in Korea, Taipei, or Japan. I think that is a very bad commentary on our business.

On the same day that I was talking about, AT&T announced a significant increase in its pension plan for management.

What do you make of that?

Mr. IRVINE. We got that same information the same day, immediately contacted AT&T, have asked to bargain over a series of issues having to do with the layoffs, having to do with what we see as a calloused management who looks very coldly at laying people off and at the same time kind of feathering its own bed. So we have asked them to reopen the contract on upgrade and transfer provisions, to allow people to transfer and to discuss the whole layoff thing and job security, employment security in general.

Senator GOLDWATER. It is hard for you to answer this question, I know, because it is hard for me to ask it.

What is the going rate per hour for your worker, not the highest or the lowest, but the average worker who is a member of your union who works for AT&T?

Mr. IRVINE. We can supply that in detail and will.

Senator GOLDWATER. I wish you would, and at the same time, if you would supply a comparable rate of the competitors in Korea, Japan, and Taiwan, also Hong Kong, Singapore.

Thank you.

[The following information was subsequently received for the record:]

COMMUNICATIONS WORKERS OF AMERICA,
AFL-CIO,
Washington, DC, September 25, 1985.

Hon. BARRY M. GOLDWATER,
Chairman, Subcommittee on Communications,
Hart Senate Office Building, Washington, DC.

DEAR CHAIRMAN GOLDWATER: At p. 107 of the typed transcript of your Subcommittee's September 5 hearing on telecommunications industry competition, you directed several questions to CWA Vice President James E. Irvine; the questions concerned comparable manufacturing wages in telecommunications in the United States, Japan, Korea, Hong Kong, Taiwan, and Singapore.

The Department of Labor's Bureau of Labor Statistics has provided printouts on manufacturing wages for 1975 through 1984 in most instances. I have prepared a chart to show "All Manufacturing" and "Electronic Products" for those nations as well as Mexico.

On p. 107, you also asked about average wages within AT&T. From our Development and Research Department, the following hourly wages were furnished, on the basis of a 40-hour work week: AT&T Communications, \$12.45; manufacturing, \$9.87; installation, \$15.54; and materials management, \$8.98. The overall weighted average used for contract bargaining estimates is \$13.96.

Sincerely yours,

JOHN MORGAN,
Assistant to Executive Vice President
Legislative/Government Agencies.

Enclosure.

MANUFACTURING WAGES--U.S. AND SELECTED COUNTRIES ELECTRIC AND ELECTRONIC EQUIPMENT
1984, EXCEPT AS NOTED

	United States	Japan	Korea	Hong Kong	Singapore	Taiwan ¹	Mexico ¹
All manufacturing ²	\$12.59	\$6.35	\$1.36	\$1.60	\$2.43	\$1.46	\$2.00
Electronic products.....	12.48	5.49	1.23	1.47	2.25	1.25	1.69

¹ Telecommunications included in 1983 for Taiwan, in 1982 for Mexico.

² Exchange rates basis: Japanese Yen, 1984: 237.4, Korean Won, 1984: 806.0, Hong Kong Dollar, 1984: 7.819, Singapore Dollar, 1984: 2.133, Taiwan Dollar, 1983: 40.66, and Mexican Peso, 1982: 72.99.

Note.—This chart is based on unpublished data prepared by the U.S. Department of Labor, Bureau of Labor Statistics, Office of Productivity and Technology, June 1985. Data for each country is captioned "Hourly Compensation Costs for Production Workers in Manufacturing Industries," with 1975 as initial year.

Senator GOLDWATER. As we have been discussing AT&T has announced massive layoffs.

Will rapid deregulation of AT&T lead to more lost jobs in your opinion?

Mr. IRVINE. I believe that is a sword with two edges in that, first, I think, yes, that is a possibility and it might happen. Second, however, I think that some of the manufactured regulations, especially Computer Inquiry 2, calls on the foreign imports because it does not allow AT&T to compete equally with the foreign manufacturers in the manufactured end.

Senator GOLDWATER. If you would like to, you can improve on that answer in any way you want. I know it is a pretty tough one to just sit there and answer, so when you get back to wherever you guys meet, talk it over.

Mr. IRVINE. Certainly, certainly.

[The following information was subsequently received for the record:]

COMMUNICATIONS WORKERS OF AMERICA,
AFL-CIO,
Washington, DC, October 18, 1985.

Hon. BARRY M. GOLDWATER,
Chairman, Subcommittee on Communications,
Hart Senate Office Building, Washington, DC.

DEAR CHAIRMAN GOLDWATER: After your Subcommittee's hearing of September 5, 1985, you directed two questions to this organization concerning the recently announced 24,000-job reduction in AT&T Information Services (ATTIS):

AT&T has announced massive layoffs. Will rapid deregulation of AT&T lead to more lost jobs? Where are these job losses coming from?

The 24,000-job cut announced August 21 will consist of a sizable but as yet unknown number of layoffs. The 24,000 positions are approximately 20 percent of the work force of ATTIS. About 7,200 jobs are management/administrative and the remaining 16,800 non-management (about 15,000 represented by this union).

As of today, CWA has been notified of 8,704 "at-risk" employees, as per the summary chart headed "Force Adjustment Executive Summary." This is only the first group. The AT&T press release of August 21 outlines the job reductions.

While the current cutback is the largest, it is not first. In August 1983, CWA was told of a surplus of 13,050 employees in ATTIS and the Bell Operating Companies—6,000 management and 7,500 non-management. Of the latter group, 6,100 were represented by CWA. A further breakdown of the 6,100: 600 were then employed by ATTIS and the other 5,500 were slated for transfer to ATTIS at divestiture, then some three months in the future.

During calendar year 1984, the BOCs eliminated 20,800 jobs and AT&T Technologies cut 43,000 jobs.

The August 1984 notification to CWA of 11,000 jobs cuts (included in the 43,000 previously cited) broke down as follows: 6,000 in ATTIS, 2,000 each in the Network Services and Consumer Products Divisions, 1,100 in the staff organization and 150 in Bell Telephone Laboratories.

Company officials, in the August 1985 announcement, indicated that further reductions and layoffs can be expected in 1986. Some estimates made by financial analysts indicate that another 15,000 to 20,000 cuts can be expected in 1986.

About 18,000 of the 24,000 jobs are to be eliminated by December 31, 1985, according to company announcements August 21 (reported in the New York Times and the Wall Street Journal of August 22 and in The Report on AT&T of August 26). Each story cited a Federal Communications Commission decision in April 1985, relaxing certain restrictions imposed in the Second Computer Inquiry. The specific case is ENF 85-13, the Memorandum Opinion and Order of which allowed AT&T to transfer six factories and their employees from AT&T Technologies to AT&T Information Systems, and to let the two sub-units share certain services and systems.

In our view, the deregulation of the above-cited AT&T operations was a proximate cause of the 24,000 job reduction. Since the company's officials cited this same FCC action, there is little doubt.

We have some strong concern that the Commission's action on September 18, in CC Docket 85-26, making further consolidations with AT&T possible, will lead to layoffs in 1986 and beyond. At this point, the non-management workforce in ATTIS has few workers left who are eligible for the several types of "early-out" programs; we are not hopeful that most of those whose jobs are in process of elimination can be transferred to comparable situations. We expect sizeable numbers of terminations. On October 10, CWA filed a Petition for Reconsideration in CC Docket 85-26, to ensure that the Commission examines its new authorization from the standpoint of employee protection, as the Commission has done in earlier common carrier proceedings.

We are studying the Commission's Notice of Proposed Rulemaking in CC Docket 85-229 to try to determine if the Third Computer Inquiry is likely to lead to still further layoffs. CWA on October 4 filed its "Interim Comments" in this docket.

I hope the foregoing will help your Subcommittee in its oversight of the evolution of the telecommunications industry.

Sincerely,

MORTON BAHR,
President.

Attachments.¹

¹ The attachments were not reproducible and are in the Committee files.

Senator GOLDWATER. If the FCC makes it easier for AT&T to cut its rates, will AT&T cut rates and costs by eliminating jobs?

Mr. IRVINE. I would certainly hope not, but I cannot answer for AT&T.

Senator GOLDWATER. Well, it is not a very good question, I have to admit, because it is an iffy question. If you care to talk with your compadres and try to answer that, fine. Otherwise just let us know, and we will scratch it.

Thank you very much.

On my behalf, Mr. Irvine, I want to thank you for appearing before us.

I am going to recognize you next. I am still trying to find out where Byrdtown, TN, is. Is there an airport there?

Senator GORE. There is no airport, Mr. Chairman, but it is right close to the birthplace of Cordell Hull. That is one of its major points.

Senator GOLDWATER. I know exactly where that is.

Thank you.

Senator GORE. I worked with the CWA on so many occasions, and I am just delighted to have a chance to hear your testimony on this.

I am wondering whether or not you think it is realistic to suppose that many of these people who have been laid off by AT&T might find jobs in some of the new competitors. You know, the classic theory is that you will see jobs lost but picked up somewhere else when the competition comes into a market of this kind.

Do you expect that to occur?

Mr. IRVINE. We certainly do. In fact, a number of the OCCs have already contacted CWA saying that when this layoff occurs, we would be happy to pick up those technicians.

Senator GORE. Well, that is encouraging, a more encouraging response than I had expected to receive to that question.

Mr. IRVINE. However, I do not think it will be 24,000 by a long stretch.

Senator GORE. Yes.

Thank you, Mr. Chairman.

Senator GOLDWATER. Thank you very much, and anything you would like to add, please feel free to do so. Your particular union probably embraces more high skills than you will find in any other union in this country. At one time many, many years ago your union and I, I believe, were rather close together, and then for reasons, we fell apart, but I still fiddle around with electronics and I am very interested in what you are doing.

Thank you very much.

The meeting will stand adjourned.

[Whereupon, at 12:30 p.m. the committee recessed subject to the call of the Chair.]

LONG-DISTANCE COMPETITION

WEDNESDAY, SEPTEMBER 11, 1985

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE,
AND TRANSPORTATION,
SUBCOMMITTEE ON COMMUNICATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 1:25 p.m., in room SR-253, Russell Senate Office Building, Hon. Barry Goldwater (chairman of the subcommittee) presiding.

OPENING STATEMENT BY SENATOR GOLDWATER

Senator GOLDWATER. The committee will come to order.

There is a quorum call at 2:30 and I will have to depart for that, as will the other members. I do not know what we will do about that, but I know there are many people here that want to be heard. But this is a very important quorum call on a very important subject. We may have to devise some way of putting your statements in the record, and I do not want to call the whole thing off just because we have a quorum call vote.

Good afternoon, and welcome to the second of 2 days of hearings on the subject of competition in the long distance markets. As each of you are aware, our country has gone through a great upheaval in the area of telephone services in the last 15 years. The subcommittee will today continue to examine a wide range of questions that have arisen as a direct result of this upheaval. Among those questions are, what equal access is, and what the appropriate amount of tariff regulation by the FCC, during the development of competition in the long distance market, should be. Quite frankly, these issues are so complex that I honestly don't feel that any group of experts in this area can agree on what needs to be done.

I continue to stand firm in my belief that the breakup of AT&T was a great mistake, however, and also recognize the concern of the OCC's and hope that these hearings will be helpful in finding a solution to these problems, if indeed one exists.

Finally, I want to take this opportunity to briefly complement two of the local companies that make up U.S. West. First, Northwest Bell for developing the procedure now in use by all of regional Bell operating companies in allocating long distance customers. And, Mountain Bell, the largest local company in my home State of Arizona, for its excellent work in the conversion to equal access. By December of this year, nearly 67 percent of Arizona, or 980,000 lines will have been converted and the work continues to be accomplished well within schedule.

After the first day's hearing, all I can say is that I have a better understanding of some of the problems, but I do not see any solutions.

It seems so complex that I do not think any expert can tell us what to do. Several of the witnesses on the first day said that what we need for customers, investors and companies alike is a period of certainty. It seems like the ground rules in this industry have been changing every 6 months, whether needed or not. Maybe what everyone needs is a little time to make it work.

We are examining a wide range of questions at the hearings. How far has equal access progressed? What more than equal access, if anything, do the OCC's need to survive in a competitive market? If the OCC's are to be subsidized in any way, who will pay? Will AT&T or the Bell companies or the consumers bear the cost of any favored treatment granted to the OCC's?

Who really holds an advantage in the present market—AT&T, with its present majority of the market, or the OCC's, who, unlike AT&T, are not regulated and are not tied to old plant investment? What impact would the link between IBM and MCI have on the opportunities for competition by other OCC's in the long distance business?

How can rural America be assured of getting good long distance services in an unregulated market? How, if at all, can stronger telecommunications foreign trade policies improve the position of long distance companies here in their home market? Would import restrictions help or hinder the OCC's and local telephone companies who want to shop around for their equipment?

Now, without prejudging the answers to these and other questions, we will be discussing, I can tell you that the answers are not found in legislation. So far we have had no legislation introduced concerning the long distance business, and I do not see any specific need to have any. It has been my experience that when highly complex and technical matters such as those of the telephone industry get tied up in the political process, parochial interest and politics take over and the end result cannot be predicted.

I think we will all be much better off if the marketplace and regulatory authorities can resolve these kinds of problems.

Now our first witnesses today are the chairman of the FCC, Mark Fowler, Commissioners Mimi Dawson, Dennis Patrick, James Quello and Henry Rivera. They are the Federal Communications Commission. I think I got everybody.

Senator Packwood, do you have an opening statement?

Senator PACKWOOD. No.

Senator GOLDWATER. OK, Mr. Chairman.

STATEMENT OF HON. MARK S. FOWLER, CHAIRMAN, FEDERAL COMMUNICATIONS COMMISSION, ACCOMPANIED BY MIMI DAWSON, DENNIS PATRICK, JAMES QUELLO, HENRY M. RIVERA, COMMISSIONERS; AND BERT HALPRIN, CHIEF, COMMON CARRIER BUREAU

Mr. FOWLER. Good afternoon, Mr. Chairman, Senator Packwood. I am delighted to have this opportunity on behalf of the Commission to discuss competition in the long-distance telecommunications

market with members of this committee. Also accompanying me today, besides the Commissioners, whom you have named, is Bert Halprin, who is seated to my immediate left, who is Chief of the Common Carrier Bureau.

My message, Mr. Chairman and members, is very simple. Transition to a fully competitive marketplace is well underway. The process is robust because it is driven by advances in technology and because all branches of the Federal Government are committed to its successful completion. Because the roots of competition rest on forces so strong and are supported by all branches of government, the future of a competitive market is basically assured.

But while we are trying our best at the FCC to foster and to guarantee a competitive marketplace process, we cannot guarantee the future of every competitive entrant. Congress' mandate, expressed in the Communications Act of 1934 and affirmed by the Supreme Court, makes consumer welfare the ultimate touchstone of the FCC responsibility.

Now, where are we today? With divestiture came equal access and competition. The question arises, How do we measure the competitiveness of the market. One point to keep in mind has to do with market shares. Market-share distribution is sometimes used as a rough indicator of the state of competition, but market share is not the only measure of competitive forces.

It appears to be a straightforward method, but, on closer examination, that simplicity is illusory because calculation of market share depends on how one defines the market. For example, while AT&T continues to provide over 80 percent of the Nation's interstate toll service, it provides only about 65 percent of the Nation's total long-distance service. More importantly, looking at market shares does not weigh the importance of potential competition.

While the FCC is committed to lowering barriers to entry so that efficient competitors can compete to increase their long-distance-market share, we cannot guarantee that market share. If we did so, we would be guaranteeing corporate shareholders profits, not the public interest. Our commitment is to competition as a process to drive down rates and choices of service up for the American people.

Today we are well into the MFJ equal-access transition. At the start of 1985 about 4 percent of lines had been converted to equal access. We expect about half of all lines served by the Bell operating companies to be converted by the end of this year. We have no reason to believe that this pace will slow in 1986. Under the provisions of the MFJ, equal access is to be generally available by September 1986, and as of now it is ahead of schedule.

It is important to understand that, for purposes of this decree, equality of access is defined not in economic terms but in terms of certain service features. Specifically, those features correspond to a service called "feature group D access." After equal access, customers no longer must dial extra digits or purchase a touch-tone phone. Transmission quality will be equal in all major respects. These characteristics are the same features identified by the alternate carriers when they came to the FCC several years ago seeking superior access arrangements.

Because equal access is a critical step toward meaningful competition, the FCC has been actively involved in the important process

of its oversight. I would like to make a couple of general points about the existing transition plan.

First, the plan is highly favorable to the alternative carriers—the competitors of AT&T. Under the FCC transition plan, interexchange carriers receive a 55-percent discount for access in those areas where feature group D is not yet available. When feature group D becomes available, the discount no longer applies. The continuation of this discount is a controversial feature of the in-place transition plan.

Some competitors would like to see it extended even if equal access becomes available under the MFJ's timetable. On the other hand, others point out that the 55-percent discount does not even recover the full cost of access services provided to alternate carriers. Moreover, the revenue shortfalls that result must be paid for by customers of carriers who receive MFJ equal access—now primarily AT&T's.

For the 12-month period ending July 2, 1985, unequal-access discounts amounted to \$1.1 billion, and this sum was recovered primarily from AT&T's subscribers. This is of particular concern to areas served only by one carrier, often rural ones, where customers are unable to avoid this heavy tax on long-distance service.

A second general point I would like to make about this massive conversion to equal access is that it has a very high price tag. Best estimates available are that on a national basis this bill will amount to between \$2 and \$3 billion.

Let me now briefly turn to three transition issues that the FCC and the carriers have resolved or are resolving on a fast track. The first concerns default traffic. As the operating companies convert to equal access, their customers are asked to choose a long-distance carrier. The Court had decided that customer default to AT&T was acceptable but some competitors complained to the FCC that this and several other aspects of the carrier selection process were unfair.

The FCC agreed and issued several rules that took effect this June 1. Most importantly, when converting to equal access, the Bell operating companies must now send ballots to customers. This encourages customer choice. Operating companies must inform their customers that if they do not make a choice they will be assigned to a long-distance carrier at random.

Mr. Chairman, may I proceed here even though my time has elapsed? I am about half way through, sir.

Senator GOLDWATER. You can either proceed or put the rest in the record, whatever you want to do.

Mr. FOWLER. I would like to, if I could, complete this.

Senator GOLDWATER. Well, I do not see a red light. It is sort of pink.

Mr. FOWLER. Thank you, Mr. Chairman.

Two other issues have been raised in a recent petition filed by a group of long-distance carriers. Since these matters are before us, I cannot predict how the Commission will act, but I will mention them briefly here.

One such area concerns access tandems. Access tandems are toll switches which are used in handling long-distance calls. In some areas where equal access has been phased in at end offices, access

tandems were not available when the changeover to equal access was made in those areas. As tandems become available at a later date, wiring must be redone. Several carriers have complained that this imposes extra cost. Most lines now being converted to equal access will be served through access tandems.

Another issue raised recently is clustering. Alternative carriers claim that their planning and marketing costs are reduced when large areas are converted to equal access at the same time. Most operating companies put primary emphasis on equal access to competitors and customers as quickly as possible. In response to complaints by alternative carriers, several regional holding companies have revised their implementation plans to cluster in metropolitan areas.

As the FCC addresses these and other longer term competitive issues, I would like to make the following observations about what guides our decisions. First and foremost, the public interest. The welfare of the American consumer is paramount.

Second, marketplace competition, where consistent with the Communications Act, is the best method of promoting consumer welfare in general. Competitive markets respond to consumer demands a lot more effectively than even the most efficient and well-intentioned government bureaucracies. But until competition is proven, the ineffective constraint on monopolistic behavior is appropriate for the FCC to scrutinize closely.

With these principles we will approach issues related to long-distance competition that will take us longer to solve, including questions of how to deal with inefficient cost recovery methods that keep long-distance rates artificially high, what to expect from the competitive marketplace in the next few years, and how to deal with AT&T's need to respond to competition.

First on the list of longer term problems is that prices charged for long-distance services remain far above costs. In large part, this is because many costs of providing local loops between customers and the telephone company office are assigned to long-distance services for cost recovery. We have begun to deal with this problem through implementation of subscriber line charges. Even after subscriber line charges are raised to \$2 per month in 1986, a large share of this problem will remain and we must still find some way to further deload toll rates. As we have promised, we will begin a comprehensive review of how to deal with this situation next year. I invite your suggestions.

A second issue we may have to face is some kind of industry adjustment. The investment now underway is nothing short of phenomenal. No industry can grow this rapidly forever. I am not predicting a dramatic shakeout, but if carriers' fortunes have their ups and downs in the future, I should note that that would be a sign that competition is working—not a sign that competition has failed. In unregulated industries, the expected reaction would be price wars, consolidations, and some bankruptcies. In regulated industries, there are strong pressures for regulators to protect individual firms in the industry at the expense of the public. As we move toward a competitive industry, those investing in the industry must recognize that they do so at their own risk. Growth of

some new entrants over the last 5 years indicate that investment rewards can be outstanding; but I would not minimize risks either.

A third issue that we must face is how to lessen the level of regulation currently imposed on AT&T. It is important to recognize that, in contrast to other long-distance carriers, AT&T is currently fully regulated as a dominant carrier, that is, a carrier with significant power in the marketplace. As a result, virtually every addition or cessation of service, and every price increase or reduction, even minor promotional offerings, must undergo advance FCC scrutiny and be subject to comment and critique by all interested parties.

Until competition is proven to be an effective constraint on monopolistic behavior, it is appropriate for the FCC to continue to scrutinize closely AT&T's pricing and investment decisions. We demand that AT&T cost justify its rates. We have concerns about AT&T's costing and its effects on consumers and competition. Thus, suggestions that we deregulate AT&T now are premature.

But while the FCC continues to view AT&T as a dominant carrier, there is evidence that its market power is diminishing over time. As competitors begin to make inroads into markets, it is seeking to respond. Every time AT&T proposes to lower prices, its competitors argue that AT&T's actions are predatory. We recognize the need to prevent predatory practices. On the other hand, we certainly do not seek to require Americans to pay higher prices than a carrier wants to charge them, absent improper pricing.

I might note that the fact we are now considering many complaints about lowered prices is one sure sign that competitive forces are working. The problem faced by most regulators is holding down prices. We, in contrast, are receiving complaints that AT&T might lower prices. The FCC is now considering a standard for judging the reasonableness of price cuts by AT&T. Economically justifiable price cuts provide clear benefits to consumers. Assuring that telephone prices are not above relevant costs is the goal of title II regulation and one of the FCC's chief responsibilities to consumers.

AT&T's pricing decisions. We demand that AT&T cost justify its rates. Thus, suggestions that we deregulate AT&T now are premature. But while the FCC continues to view AT&T as the dominant carrier, there is evidence that its market power is diminishing over time. As competitors begin to make inroads into their markets, AT&T is seeking to respond. Every time AT&T proposes to lower prices, competitors argue that AT&T's actions are predatory.

We recognize the need to prevent predatory practices. On the other hand, we certainly do not seek to require Americans to pay higher prices than a carrier wants to charge them, absent improper pricing. We like price cuts for the people. We have a statutory duty to prevent AT&T from exercising any monopoly power, and we take that duty very seriously. At the same time, we also take very seriously our responsibilities to promote competition and to achieve as rapidly as possible a level playing field.

Before closing, I would like to present a snapshot view of the long-distance marketplace today. There are a large and rapidly growing number of firms providing interstate telephone service. In January we published a list of 250 carriers that opted to file their

interstate tariffs with the Commission. Many others, such as the Yavapai Telephone Exchange, which provides nationwide service from Sedona, Cottonwood, and I believe that is Chino Valley, AZ, are not listed because they did not file FCC tariffs.

Not only are there more and more firms in the business, but many of them are growing steadily. As shown in the following charts.

Number of customers served by MCI

March 31, 1979	16,000
March 31, 1980	41,000
March 31, 1981	280,000
March 31, 1982	734,000
March 31, 1983	1,179,000
March 31, 1984	1,613,000
December 31, 1984	2,173,000

Source: MCI Annual Reports to Stockholders.

Number of customers served by Sprint

1979	47,000
1980	80,000
1981	200,000
1982	535,000
1983	943,000
1984	1,347,000

Source: GTE 1984 Annual Report.

The numbers of customers serviced by Sprint increased 40 percent in 1984. MCI, which now serves 407 of the Fortune 500 companies, increased its customer base by 35 percent in the last nine months of 1984 alone.

We now find a wide variety among long-distance firms. Some specialize in serving business customers. Others specialize in serving residential ones. Some build their own long-distance transmission facilities while others concentrate on resale. Some firms are now emerging with the goal of serving as wholesalers only, marketing their transmission capacity only to other carriers. Some seek to serve nationwide and others, like Yavapai, are concentrating their efforts in regional markets.

Long-distance firms offering very specialized services, such as specialization is an indicator of healthy competitive activity and perhaps an even more important indicator of commitment to the long-distance telecommunications marketplace is the investment made in competitive long-distance facilities. In 1984, MCI invested \$1.1 billion in new plant and equipment. At Sprint, capital expenditures have risen from \$85 million in 1982 to \$300 million in 1983, to about \$800 million in 1984, and \$1 billion in 1985.

Other smaller firms are also investing heavily, especially in new fiberoptic transmission systems. Most of this activity began well before equal access was widely available. With divestiture and commitment to providing equal access, a firm foundation has been provided for even more vigorous competition.

Mr. Chairman, fair competition must be allowed to prove itself out in the marketplace. The very essence of competition is striving to acquire and keep customers, and that striving is precisely what it is about competition that redounds to consumers' advantage. The American people who bear the billions of dollars of costs backing

this national commitment to equal access must reap its fruits. Consumers who have borne the confusion of divestiture must benefit from the increased choices lower prices and effective competition can bring.

Mr. Chairman and members of this committee, the outlook for this process is favorable. The FCC is dedicated to that process. We are moving prudently to bring about the transition to full competition, while balancing all of the considerations involved. We appreciate your interest in our work and I will be happy, as will the other commissioners, to answer any of your questions.

SUMMARY

The transition to a fully competitive marketplace is in progress, and when complete, long-distance competition will be here to stay. With the introduction of competition to AT&T's long-distance service, new entrants were faced with an inability to interconnect with local companies on the same terms and conditions as AT&T. Now with the modification of final judgment approving the AT&T divestiture and actions taken by the FCC, competitors with inferior interconnection to the local network pay a substantially discounted rate until, end office by end office, the connection is upgraded to be equal to AT&T's. About one-third of the Bell Co's. end offices have been converted to equal access to date; and equal access must be generally available by September 1986.

There are several issues relating to the transition to equal access, which the FCC either has resolved or is committed to resolving quickly. To assure fair treatment of competitors and encourage consumers to make affirmative choices, we have mandated a ballot and allocation procedures for areas converting to equal access. We are examining OCC concerns about the transition to equal access, including availability of access tandems and "clustering" of end office conversions. We are also looking at the question of how to regulate AT&T during this period of transition to a competitive environment. In the longer term we still have to look at further "de-loading" toll rates to move long-distance prices closer to costs. Finally, we may have to face some kind of industry adjustment in the future. The present phenomenal rate of growth for the industry cannot be sustained forever. If some carriers succeed and others fail, it can be reasonably viewed as the workings of the competitive process. It should not be interpreted as a sign that the FCC's policies or the competitive process itself is not working.

As we have in the past, the FCC will continue to place consumer welfare first and foremost in its decisionmaking. We believe that marketplace competition maximizes consumer welfare to a greater degree than regulation. We have evidence, both in the numbers of competitors and in their massive investments, that the competitive process is robust. The FCC is committed to that process. We pledge to continue to balance all considerations involved in this transition as we move toward full competition.

Senator GOLDWATER. Thank you very much, Mr. Fowler. Before we question you or the Commission, Mr. Rivera has a statement and because we are losing him later this month, I believe, and we

regret very much losing you, you go ahead and make your statement.

Mr. RIVERA. Thank you, Mr. Chairman. I believe that in the interest of time I would just as soon that it be inserted into the record, if that is all right.

Senator GOLDWATER. Thank you. That is very thoughtful of you. [The statement follows:]

STATEMENT OF HENRY M. RIVERA, COMMISSIONER, FEDERAL COMMUNICATIONS COMMISSION

Good afternoon, Mr. Chairman and Senators.

I commend you for holding these hearings on long distance competition. The topic and issues are complex and controversial, for, you will find, even the way the issues are framed could affect the interests of those involved. You have had the foresight to begin the educational process now, focusing your attention in order that any oversight you deem appropriate will be timely and effective.

I appreciate the opportunity to appear before you today. It has given me an opportunity to reflect back over my term as Commissioner, which, as you know, will end this Sunday. In the interest of full disclosure, I want to bring to the Committee's attention that the law firm I will be joining—Dow, Lohnes and Albertson—represents a trade association of small and medium size long distance service resellers. Furthermore, one of my legal advisors recently began employment discussions with a large telecommunications corporation that is not presently involved in inter-LATA operations. For these reasons, I will confine my remarks to long held and previously publicly expressed beliefs.

As you know, the FCC's process of deregulating telecommunications—a process begun almost 30 years ago—was not begun by conscious design or with the benefit of a comprehensive plan. Nevertheless, since that beginning, it has evolved rationally and systematically. As effective competition has increased, so have the FCC's deregulatory initiatives. The effort has been driven by the following philosophical objective: to achieve a deregulated telecommunications market "controlled" by, and reactive to, effective competitive forces where the relevant social considerations permit. Where consistent with our statutory mandate, we are looking for meaningfully "competitive" marketplace forces to supplant regulation.

We have learned that competition and deregulation reinforce each other in a pyramiding fashion. Fostering competition is a predicate for deregulation. Fostering competition is a deliberate process that involves the careful and studied deregulation of portions of an industry as competition increases. It is not achieved by deregulating all aspects of an entire industry overnight. Increased competition, in turn, provides the foundation for additional deregulation. And reduced regulation can promote new market entry, alternative sources of supply, and innovative services. An excellent example of this process can be found in the logical, progressive extension of our Competitive Carrier policies.

I do not agree with those who characterize the FCC's efforts in the common carrier arena as a rampage to deregulate the industry for the sake of deregulation. It has been a timely, evolutionary process . . . predicated on pro-competitive regulatory initiative and the creation of effective competitive forces. In the large majority of cases, I have supported that process. There have been a few instances where I have deviated from my colleagues. First, when I believed their approach added unwarranted change to the ground rules and thereby uncertainty to the industry and consumer environment. For instance, the abrupt reversal from flat rate charges to usage-sensitive charges for nonpremium access made in the Third Reconsideration of the Access Decision. Secondly, there have been a few instances, where I have believed that my colleagues seemed to be utilizing an indulgent approach to the tariff review process by allowing proposed tariff provision to be effective despite wholly inadequate cost support. For instance, the unprecedented acquiescence to AT&T's proposed \$75 million increase in short-haul (0-55 miles) MTS rates which were allowed to become effective on less than the normal notice period devoid of any cost support data. This extraordinary waiver of procedural and substantive public safeguards occurred without any emergency being asserted by the carrier. But, let me emphasize that these instances of divergence have been few. In the past, I have supported the general pro-competitive/deregulatory policy and its implementation in the common carrier area notwithstanding its reactive, single-step nature.

Let me focus now on the FCC's deregulatory initiatives for the foreseeable future. Implementation of the Divestiture, equal access, and the Access Decision will have

profound effects upon the market structure of this industry. The Commission needs time and experience to evaluate the progress and impact of its Access Decision and the Divestiture, particularly upon the essential foundations of our telecommunications system—universal service and network preservation. There should be no doubt that those immediate, overriding policy concerns—universal service and network preservation—should set the pace of future deregulation in the common carrier marketplace. Likewise, we need to assure that the benefits of competition (not just the costs and burdens) flow to all . . . rural and urban, residential and business, small and large.

From our past, largely favorable experience since the 1950s, we have gained the ability and the confidence to explore a coordinated approach to long term telecommunication deregulation. At this point, given the profound implications of additional deregulation, a cautious and coordinated approach is the most responsible way to proceed. The deregulatory process has matured sufficiently to develop and implement an overall policy framework in the place of our past single-step approach.

As we start shoveling out from the MFJ aftermath, it is imperative that the Commissioners focus the FCC on long term directions for the industry, rather than continuing in a reactive mode. Robert Frost once observed: "Some people worry because, science doesn't know where it's going. It doesn't need to know. It's none of its business." However, from our Congressional mandate, where the telecommunications industry is going is the business of the FCC. The single-step approach of past FCCs is inadequate.

Toward that end, we have undertaken a broad inquiry to address the legal, political, economic and practical implications of continued regulation of the domestic service and facilities of AT&T, the dominant interexchange carrier. This docket, called Long-Run Regulation of AT&T's Basic Domestic Interstate Services, should explore the costs and benefits of continuing the present regulatory scrutiny of AT&T through 1990; options for alternative regulation of AT&T; the conditions under which we might pursue each option; and approaches for accessing AT&T's future market power.

Furthermore, the Commission has instituted a proceeding which will explore recommendations on the scope and mechanisms for allowing AT&T meaningful and fair competitive pricing flexibility in its offering of new MTS rate elements, discounts and pricing packages during the transition to a fully competitive environment. In addition, the Commission is reassessing the Computer II framework, overall, and the structural separation requirements, in particular.

Some have criticized the Commission's broad inquiries regarding continued existing regulation of AT&T as being nothing more than part of an ad hoc deregulatory effort. I would hope that these critics have misread the Commission's intent. However, the FCC and Congress must be wary that these broad inquiries do not evolve piecemeal into isolated decisions involving only individual aspects of overall policy issues. It would be foolhardy to conduct a transition to competition and deregulation without first having developed a comprehensive plan for that transition. Likewise, the FCC must focus on the aggregate impact of individual deregulatory actions on the current state and future of competition.

We all must recognize that premature and nearsighted deregulation could ultimately do great damage to the development of an effectively competitive telecommunications environment. Congressionally reimposed pervasive regulation could be the result.

We do not have many answers now. Indeed, we are just beginning to frame the questions. Alternative long distance providers have asked one of the most vexing—will there be any competitors to AT&T once the transition to a competitive marketplace is completed? We do not know the answer to that question. Indeed, we do not even know if we ought to ask it. The coordinated completion of the various proceedings I mentioned earlier will help us greatly in determining whether we ought to ask the question.

Reliance on the Free Market is the end. It is not the means to achieve a fully competitive marketplace. The means has not yet been devised. So, I would submit that to rely exclusively on the Free Market, at this time, is akin to abdicating our responsibility to manage the post-Divestiture transition so that it has meaning for the people of this country.

What must be done now is to develop a policy—what do we want and how are we going to get there? Do we care whether the alternative long distance industry is a healthy one? If so, what additional steps, if any, are necessary to assure its health? This is not a question simply of deciding whether a subsidy should continue to assure the viability of particular carriers or not. It is a question of this Commission making a conscious determination about what will be the telecommunications policy

of the United States regarding the existence of competition in the long distance industry.

Thank you.

Senator GOLDWATER. Mr. Chairman.

The CHAIRMAN. Mr. Fowler, I think that all of us believe that the question of exactly how deregulation of the telephone industry is accomplished and how the new system is phased in is more of a judgment to be made by people who deal with these things on a day-in/day-out basis than a congressional judgment.

My concern is not precisely what the Commission does but whether it does it, whether the Commission is in fact attentive to the problems and the difficulties of moving into a new environment, whether the Commission is a forum which is open to those who express concerns, particularly the OCC's, the new participants in this long-distance enterprise, and whether the Commission is proceeding in an orderly fashion and a fair fashion.

And in a way that does not indicate that it's prejudged results or that it is trying to superimpose a philosophical position on the very real concerns of the various competitors for long-distance service.

I would just like your comments on these basic concerns and I would like your assurance, if you can give it to me, that the Commission is in fact a forum, that the Commission is objective, that the Commission does have an open mind, and that it is not ideologically bent in one direction or another. I am told that people at the Commission have referred to competitive carriers as extortionists and as "Chicken Littles."

If that is the case—and I do not know if it is or not, I am just told that, but if that is the case, it would indicate a certain lack of objectivity and lack of being receptive to a real consideration of real concerns of people who have committed themselves to this enterprise.

Mr. FOWLER. Chairman Danforth, I want first of all to assure you that this commission, I am confident, is an impartial expert forum for complaints that have been filed, in the latest instance, a petition by several of the OCC's making certain allegations which I think it is vital we look at and look at carefully, and that we look at promptly because, as you know, this process is a very dynamic process. Therefore, it is important that we move to resolve that petition as quickly as we can, and we will; we are working on that right now.

As for the two staff utterances that you mentioned, I first of all would point out that those are simply, in one case, a staff article and in the other case a staff speech. Those are the opinions of the authors. It is also important, if one reads both of those items, that you will find that there is a balance there, that there is no predisposition on the part of any of our key decisionmakers to favor one side or the other.

But having said all of that, I think the proof is in the pudding. That is, what we do. And I think that our record in terms of being impartial and fair in arbitrating between AT&T and the OCC's as to this interexchange competitive market has been an outstanding one.

The most recent example of that is an initiative by this agency to reverse a previous decision which we had made involving how per-

sons who do not subscribe, that is, who do not make a choice as between AT&T and their competitors when equal access occurs, will be allocated to the competing carriers.

Prior to our most recent decision, those who did not make a choice as between AT&T and others, as you know, Mr. Chairman, were simply defaulted over to AT&T. We looked at that. Upon reconsideration we felt it was not fair. It was not fair to the process and we ordered a new plan which provide that those who do not make choices will be allocated on a pro rata basis, based upon those who do make a choice. That was fair, clearly, to all of the competitors of AT&T.

We recognize that the customers who were being simply defaulted to AT&T were ones that had been gained by virtue of a monopoly position over the years, and it was not good policy to continue that practice.

But we have rejected several tariffs that AT&T has filed, the latest being Accunet. We suspended another tariff which OCC's had filed some very vigorous objections to regarding a new pricing plan to provide rate cuts to high users of conventional long distance or MTS service. So the Commission is on the job and in those instances I have cited I am sure that AT&T did not like our decisions.

We made those because our touchtone is consumer welfare. It is not concern for AT&T or the OCC's, but the consumer. But in making those decisions we will continue to be impartial. I give you that assurance.

The CHAIRMAN. Do you think it is in the best interest of the country that the OCC's be in a position in which they can survive and can continue over a period of a number of years to provide good healthy competition for AT&T?

Mr. FOWLER. Yes, we think that the goal is to achieve full and fair competition in this market, and that is what we are dedicated to.

The CHAIRMAN. And if just putting them out there and cutting them loose ends up in their demise, would you agree that there should be at least some effort to keep them alive?

Mr. FOWLER. First of all, we do not see any evidence of that occurring. In fact, what we see is quite the contrary. As I indicated in my testimony, the amount of money that the investors of these companies are committing to construction, for example, is increasing every year. This tells us more. It speaks volumes, really, that they think that this is a competitive market, that they can compete with AT&T. And so I do not think we will have to face that question, and we will do everything we can to move to a market where there is fair and full competition.

At the same time, I think our role is to make sure that there are no unfairnesses in the way we administer the Communications Act. But if a competitor, because of marketplace weaknesses, poor management or poor business plan, fails, I do not think in that instance the Government should move in and intervene to prop up that particular competitor. That is not the competitive process and that would not serve the American people well because it would artificially keep rates higher than they need be.

The CHAIRMAN. Thank you, Mr. Chairman.

Senator GOLDWATER. Senator Rockefeller, do you have any questions?

Senator ROCKEFELLER. No, Mr. Chairman.

Senator GOLDWATER. Senator Ford.

Senator FORD. Mr. Chairman, I have a question or two, and I am not sure that I have it all in the right perspective, Mr. Chairman. Maybe we can get to the essence of it.

Would you say that your agency's primary goal for telecommunications policy today is to ensure the development of competition or to oversee complete deregulation?

Mr. FOWLER. I would say that our mission is the former—that is, to promote in this market that we have under discussion here full and fair competition, to promote consumers' interests.

Senator FORD. Well, your idea of deregulation or regulation or continuation and maybe some others may differ somewhat. I suspect in your perception of what you are doing is regulation, but it may be deregulation. I think we want to get part of this on the record, and, Mr. Chairman, I am also concerned about the rural telephone users, that they not be victimized by the upheaval of the telecommunications industry.

Also, I understand that the Bell System divestiture, whatever it merits, is an accomplished fact, and it seems then that the protection of rural subscribers must come either from rigorous regulation or from effective competition.

Do you believe that rural consumers today have real options regarding long-distance services?

Mr. FOWLER. No, I do not think so today.

Senator FORD. Are you concerned about the possibility of rate deaveraging, I guess is the word you would use, causing substantial rate increases if deregulation is enacted?

Mr. FOWLER. Senator, not only am I concerned, as long as I am Chairman I would not permit the Commission to even consider such a thing. I think that the average, the geographic averaging that we require now of AT&T—and we do require them to provide service to all parts of the country—is vital in preserving universal service, as we define that term.

I am committed to that, and we have never proposed even to look at changing that policy. That is why we require AT&T, if it comes in with a new or innovative pricing plan, to offer it to all customers nationwide. That includes rural subscribers. In other words, if it is making a response to competitive pressures, to metropolitan areas where the competitor is now serving and competing with AT&T, they do not have the same obligation to serve rural areas.

But if AT&T wants to make a competitive response, we have said that if we approve such a competitive response—for example, lowering prices—we would require that they offer that to the rural subscribers, all AT&T subscribers. That is to prevent them from using those areas where there is not competition to subsidize punitive cuts in areas where there would be competitive forces operating and to ensure that people in rural areas enjoy the benefits of the competitive process, at least to this extent, even though the other competitors are not yet serving rural areas directly.

Senator FORD. Well, if full deregulation is enacted, does that not put the rural customer at the mercy of deregulation of whatever

the competitors want to charge? They are locked in, and you know they are locked in. They are captive users, so to speak.

Mr. FOWLER. Yes, they are, in most cases now, yes, sir.

Senator FORD. But are you not concerned about the full deregulation?

Mr. FOWLER. We have no proposals to deregulate AT&T in those areas at all, Senator.

Senator FORD. All right. I am just getting it on the record.

Mr. FOWLER. Yes, sir. We are strongly committed to that policy.

Senator FORD. The path you are on now, as it relates to the breakup and the competition as it relates to long distance and that sort of thing, do you see any change or are you just going to stay on the same path, or do you see bouncing back and forth, doing different things in the out-years?

Mr. FOWLER. I see now essentially a Commission that has set a policy in place and in the long distance area I think the most important of those policies or subpolicies is equal interconnection. That is, it is vital that we enable the competitors of AT&T to be able to compete on an absolutely level playing field, and that is why the equal access process is vital to fostering competition, and we are dedicated to ensuring equal access comes as quickly as can be devised, consistent with an orderly process.

We will continue to monitor that process, to inquire of the BOC's on a quarterly basis how the process is proceeding. We have set up other requirements for the non-BOC companies, GTE and the independents, and timetables concerning when they will implement equal access in their service areas. That is the most important sub-policy.

The overarching policy or principle, though, is to move to an environment in this market where we have full and fair competition. That means that the competitors are able to compete with AT&T fairly and fully, and also vice versa. We cannot and should not artificially handicap AT&T in ways that are not in service of the public interest.

Senator FORD. Well, if I understand you correctly, then, the path that you are on now will be one that is steady and consistent and those who are venturing into deeper water will not have to be looking back over their shoulder for a short rope.

Mr. FOWLER. No, sir, and I think these policies, including the discount phaseout, have been understood for several years by the competitors, and we have not deviated from the implementation of that policy in any significant respect.

Senator FORD. My two questions basically apply to AT&T and to those that are trying to get into the arena, and so we will see. Of course, we will have you back up here, I guess, on occasion, or somebody like you.

Senator GOLDWATER. Senator Rockefeller.

Senator ROCKEFELLER. Just one question, Mr. Chairman. One of the general debate issues now is with respect to AT&T's Reach Out America and whether or not that is predatory with respect to competition or simply a good business matter. Now the OCC's are also offering incentives and the question I would ask you is how, in your own mind, do you make the differentiation between an incentive of that sort, a scheme of that sort, which is predatory in its

nature with respect to the anticompetitiveness and fair playing field as opposed to when it would be described as simply good business?

Mr. FOWLER. Well, we have a proceeding now outstanding, Senator, that asks that very question. That is, it is a notice of proposed rulemaking looking to the question of what kind of standard we might be able to use to provide AT&T with more flexibility. For example, if they want to offer a pricing plan which targets some cuts to a particular group of MTS or long distance customers, what standard would we employ.

We are asking that very question now because we recognize that it is vital that we provide AT&T with maximum flexibility in a competitive environment to make competitive responses. At the same time, every tariff that AT&T files—and they must file tariffs because we subject them to the full panoply of communications regulation, unlike their competitors—has to show that the costs are justified, but that the costs are not predatory.

So on the one hand we have to make sure that costs are not predatory and on the other hand it seems to me we have an obligation to give them the maximum flexibility consistent with our statutory responsibilities to respond to other competitors. And as I said to Senator Ford a moment ago, for the time being that probably will be the only way that rural subscribers will see the benefits from divestiture and the equal access process.

As AT&T is permitted to have more flexibility, for example, the optional calling plan is one you mentioned, it seems to be very popular so far. We are happy if consumers like to try and do things, and we like to see price cuts or packaging of long distance in different and innovative ways. That is good for the consumer.

Senator ROCKEFELLER. Thank you.

Senator GOLDWATER. Senator Packwood.

Senator PACKWOOD. Mr. Chairman, clear up the confusion I find between market share. I cannot find in your statement right now what you said about the 90 percent and 75 percent, or what were the figures that you used?

Mr. FOWLER. I think I said over 80 percent in interstate long distance, and then the other figure was 65 percent of the total long distance market—that is, if you include intrastate.

Senator PACKWOOD. The reason I ask is Mr. McGowan in his statement says AT&T continues to exert monopoly power in the marketplace with an overwhelming share of 85 to 90 percent of the long distance business in the United States. Mr. Brown says AT&T's market share is now about 63 percent, according to the Department of Commerce.

I am simply confused about apples and oranges, as to what those different statements are talking about.

Mr. FOWLER. The answer is, Senator, that they are looking at different markets, and if you look at different markets or define them different ways, you get different numbers.

Senator PACKWOOD. I understand that. What are they talking about?

Mr. FOWLER. Well, probably Mr. McGowan is clearly talking about interstate, and Chairman Brown may be talking about the

long distance in general—that is, intrastate and interstate. I do not know for sure.

Senator PACKWOOD. And what is it you are talking about when you use your figures?

Mr. FOWLER. Well, I use both figures here. The higher figure is simply interstate, and the other includes intrastate competition as well.

Senator PACKWOOD. Thank you.

The CHAIRMAN. Mr. Chairman, because all Commissioners are here, I wonder if I could just put hopefully two brief questions to them.

First, on the question of timing of pricing flexibility for AT&T, do you have a view as to when that should happen or maybe it is not appropriate to ask the question, but could you give us your idea of timing for AT&T receiving more flexibility in pricing?

Mr. FOWLER. I do not know exactly when the date would be on that notice of proposed rulemaking, but I can tell you this, that it will be sooner rather than later, and the reason for that is, if in fact we can provide AT&T with more flexibility, still treating them perhaps, however, as a dominant carrier and still subjecting them to the full rate of return rate base regulation under the Communications Act, but nevertheless provide them flexibility to provide price cuts or new and innovative services, and provided that we require that they provide that service to every subscriber in the country, including the rural areas, that is the only way that we can bring benefits to rural areas.

At the same time you will notice that I said, I put a couple of caveats in there. A, they may not file and effectuate predatory prices. They cannot have prices that are above their rate of return the other way, and we will look at each tariff as it is filed to make sure that it meets those guidelines.

But what we are asking in this proceeding is may we give them more latitude within those constraints.

The CHAIRMAN. Could I hear from the other Commissioners? I mean, very briefly, please.

Mr. QUELLO. First of all, I agree substantially with what the Chairman said. I read his statement carefully and I am in agreement. I think if you have been following the Commission processes lately I have not exactly been a rubberstamp vote for everything he proposes, but I agree with him here.

I just want to say, Senator, that I think that, yes, eventually we have to give AT&T more flexibility. But in the meantime the OCC's should be able to do pretty well. Now, although some of them have mentioned that their profits are down, they have that enormous investment in plant, over \$1 billion for, say, GTE and MCI.

But here are the things that the Commission has done to make it more competitive. First of all is the 55-percent discount. Second, the Commission has imposed no obligation to serve on the OCC's. They are free to serve any area they want, and they are free to serve the areas that offer the highest profit potential going in.

The other thing is the OCC's have primarily targeted, of course, naturally on customers that are in high volume—

The CHAIRMAN. Again, just because all of the Commissioners are here, the brief answer that I was looking for had to do with your general theory on timing.

Mr. QUELLO. All right. I was taking advantage of this thing to summarize my whole position. The timing, as I say, I do not think we have decided that, but it is on our minds and we should get at it.

But I did want to say this thing, among other things, on going back to my points—I will just end it quickly—is that the OCC's do have faster depreciation. That is a very important thing that seems to be overlooked by everyone. Their depreciation rates are not regulated by the FCC. They can call out their own and the IRS depreciation rates are a lot more liberal than those of a regulated monopoly.

The CHAIRMAN. I just wanted to hear from the Commissioners on the timing, please. Mr. Patrick.

Mr. PATRICK. Thank you, Mr. Chairman. Let me see if I can respond to your question with respect to timing on pricing flexibility. As the Chairman indicated, we have a notice outstanding right now with respect to guidelines that might apply to so-called optional calling plans.

So I think the first answer to your question is it will depend upon the comments that we receive in that proceeding. This is one of the most complex areas that I think the Commission is dealing with at the present time.

The second answer to your question from my own perspective, Mr. Chairman, is that if we find, after having carefully and thoroughly evaluated the comments, that we can provide for pricing flexibility in a manner that would not be predacious, would not be anticompetitive and therefore would not have that sort of detrimental impact upon the development of competition in these markets, then I think that we have an obligation or would have an obligation to very seriously consider providing for that flexibility.

On the other hand, Mr. Chairman, I think we all recognize that this is a very, very sensitive time in the development of competition in the interexchange market, so I think you will see that the Commission will continue to be very cautious in this area.

The CHAIRMAN. The other Commissioners?

Mr. RIVERA. Senator, my concern would be that the timing be coordinated with the other proceedings that the Commission has outstanding at this time, specifically long-run regulation of AT&T. It would be very unfortunate for the Commission to go forward on a piecemeal ad hoc basis to decide these very critical issues in isolation because they all affect one another.

And so I would be very concerned about the Commission timing this particular docket with its others so that we reach a decision on all of them at least around the same time.

The CHAIRMAN. Your concern is that deregulation should be a step at a time in testing the effects of each decision and not doing anything in a pell-mell fashion?

Mr. RIVERA. Yes, sir, that is correct.

The CHAIRMAN. Mrs. Dawson.

Mrs. DAWSON. Well, I think, Senator, that I would take a more cautious approach. I think that we are in a period of providing

equal access to all interexchange carriers and that process, I am firmly convinced, will be completed for the BOC end offices by September 1986. Prior to that time I guess I would err on the side of caution and be quite sure that anything we might do in terms of interim flexibility be very stringent on costing standards.

I do think also that we do tend to focus on timing of deregulation of AT&T as it relates to potential competition with the OCC's. I think we are forgetting that, in that timing equation, one must consider that there are other dominant carriers, the BOC's, who can act as a very important competitive element in that marketplace.

The BOC's, AT&T and the OCC's are all competing for the same large business customers, and if we allow other dominant carriers to have the same kind of pricing flexibility, then I think we need not center so much on AT&T versus the smaller OCC's. And we will have numerous large, well-financed, well technology based competitors in the market.

Mr. FOWLER. Mr. Chairman, if I could add just one thing, I disagree to this extent with one of my colleagues at least. I do not think it is in the public interest that we artificially delay consideration of permitting AT&T to offer plans that might provide new consumer benefits. I think we have a responsibility that is far more important than the status of any individual competitor.

Assuming that we find that tariffs that are filed by AT&T are not predacious and meet all of our other legal requirements, I think we are being extremely cautious. We are in this proceeding that is ongoing now, that you referenced, and which we would like to consider further in the near future, treating AT&T as a dominant carrier, that is, a carrier that has the ability to be able to raise prices without penalty.

So we make that assumption, that they are dominant, and we will continue to use that as an axiom or a basis until at some point in the, I think, not near future but somewhat more long-term future a future agency is able to say they are no longer dominant. But all of our decisions assume and treat AT&T as dominant. I think that is important to understand because that is erring on the side of caution.

The CHAIRMAN. Thank you, Mr. Chairman.

Senator GOLDWATER. Senator Hollings.

Senator HOLLINGS. Mr. Chairman, with respect to AT&T's costs, in years past we were told in the original Bell hearings that we would look into that very thoroughly once and for all and determine their cost of services. Now with respect to the short haul service we had a \$75 million increase in tariffs with a short 15-day notice, and the Accunet tariff, we allowed that to go in without knowing the cost. As I take it, it has now been withdrawn, and then the FCC permitted one single customer to use the SDN service before determining the cost of service there and what the tariff should be.

So I am disturbed that I do not know how to vote and how to make a judgment because I still do not know the cost of service of AT&T. Do you have that?

Mr. FOWLER. Senator, I am not clear what proceeding you are referring to, what decision.

Senator HOLLINGS. The Bell decision, just your general responsibility. Mrs. Dawson seems to know.

Mrs. DAWSON. Senator, I think that there is a concern, and I must suggest, as has my colleague, Commissioner Rivera, that we need to make a decision on the extent of cost information that is necessary and the time available to review it especially in this very critical timeframe over the next 18 months.

I think, however, that it should be pointed out that in those cases where the Commission has had questions in terms of cost—while I might have thought we should have waited—we have clearly investigated those tariffs, and in cases where the cost information was not adequate we have found them unlawful.

Senator HOLLINGS. And the overall cost of service, most respectfully the 18 months you refer to really, as I see it and have been working with this problem for at least 7 to 8 years, the goal, you had to be a detective and we cross-examined our good friend Charlie Brown. We cross-examined the Chairman of the FCC and everyone else just what is the cost of service. What is allocated to long distance?

We asked one gentleman Mr. Kahn, that came here from New York and said that the local telephone user was subsidizing the long distance so we have had all kinds of rather respectful testimony, and here I am playing the game now. I have been playing the game for 19 years, and I still cannot tell you the cost of service. I would just like to know if the Federal Communications Commission has an analysis of AT&T's cost of service.

Do you, just generally speaking, and then we can break it down from there. Accunet may come in and another increase might be given and everything else like that. Just so we have a background of resourceful knowledge to pit that judgment upon, it seems like if I was on the FCC that would be the first thing I would order.

I would say we will all adjourn until we get the real cost in here and from there on we will then reconvene and start making sensible judgments. But right now they are all guesses.

Mr. FOWLER. Well, I do not think they are all guesses, but it is certainly an imperfect process. I agree with you on that.

Senator HOLLINGS. Do you have the costs for AT&T?

Mr. FOWLER. You cannot, where matters deal with allocation of equipment that is used for various services reach a perfect allocation among those services. We know that. We have recognized that and regulators the world over have recognized that.

But within certain disadvantages that we suffer as a result of that imperfection I think we have done a fairly good job. Now the Accunet tariff that you mentioned, we found that AT&T had not made its case. So what happened with Accunet? We did not let it go in; we rejected it.

Pro-America was filed with us. We are looking at that now.

Senator HOLLINGS. Do you have AT&T's cost of services, generally speaking?

Mr. FOWLER. Generally speaking, yes, sir, we have them. We have enough that we think we can make intelligent policy decisions. The problems are in the areas where we do not have effective competition yet.

Senator HOLLINGS. Well, I go along with you on the competition, but just on the costs. What we tried to do then—and I do not want to belabor because we have some important witnesses otherwise, and another vote coming up—let our staff, if you do not mind, work with you and you give them what you have and here is the general background and framework from which the Federal Communications Commission works and makes its decisions on the cost of service of AT&T, if I could get that from you.

Mr. FOWLER. Yes, sir; we will work with you.

Senator HOLLINGS. I appreciate that very much.

Thank you, Mr. Chairman.

Senator GOLDWATER. Senator Inouye.

Senator INOUE. Mr. Chairman, because of the importance of the matter before use and its complex nature, I have gone ahead to draft a whole series of questions which I would like to submit for Mr. Fowler's consideration. But in order to give us some indication as to the thrust of my questions, I would just like to touch upon some of them.

My first question. Some of AT&T's competitors contend that the promise of competition in the long-distance market is threatened by Government policies which fail to recognize the many advantages AT&T has over its competitors due to its price status as a monopolist and that these advantages must be counterbalanced by appropriate regulatory action. And I have listed down some of these contentions that competitors feel require such regulatory action.

My second set of questions, some critics believe that deregulation of AT&T has been premature and places the development of competition in serious jeopardy and the allegations set forth by these critics have been compiled and I put them down here and would ask for your thoughts.

And, finally, critics of the FCC's current transition plan contend that it leaves new carriers no alternative but to adopt temporary and costly measures to compensate for the many advantages held by AT&T and consequently they must spend a larger proportion of their revenues on advertising, construction and operation, while simultaneously continuing to charge rates significantly below that of AT&T. And I have set forth some of the problems as seen by these competitors, and I have asked for your thoughts on these.

Mr. FOWLER. I would be delighted to respond, Senator. Thank you.

Senator INOUE. Thank you very much.

Senator GOLDWATER. Senator Gore, do you have anything?

Senator GORE. Thank you, Mr. Chairman. Yes; I apologize to the witnesses and to you for being a little bit late, but I have reviewed the testimony and I have just a few short questions because I know what the time pressures are.

Mr. Chairman, would you describe briefly how toll rate averaging works?

Mr. FOWLER. Essentially what we have done is require AT&T to average the cost of providing long-distance service nationwide and then to charge every one of the consumers the average rate, and I am simplifying this greatly. That is important for rural subscribers

because typically, as you know, Senator, rural areas such as, I believe, Carthage—

Senator GORE. You must have watched our last hearing on C-Span.

Mr. FOWLER. Yes, indeed, and I read the transcript too. But in those areas typically the costs are higher, so by averaging cost we bring the cost down of providing them long-distance service in those areas and we are committed to continuing that policy. I would not, as long as I am chairman, even begin to consider changing that.

Senator GORE. Good. That is the commitment I was going to seek from you, and you took a shortcut to get to it, and I appreciate it very much.

Let me just follow it up by saying I think it is correct to state that the FCC is leaning toward accelerated deregulation of AT&T and let us accept for a moment or hold in abeyance for a moment the wisdom of that policy. Is it fair for AT&T to have to average tolls to customers it is required to serve, as I think it should, while its competitors are free to serve anyone at rates undercutting AT&T and in mostly urban areas?

Mr. FOWLER. I think that the question of fairness really is transcended by a public interest to ensure that all of our people enjoy long-distance telephone service. It may not in an academic sense be totally fair that AT&T is singled out, although one could argue that because they were a monopoly for so many years and had the advantages of that that they ought to be able to continue to provide that long distance service in the new environment.

The bottom line, though, is that at the same time—and I think your question suggests this—AT&T should have the ability to be able to make competitive responses, particularly since the OCC's have no obligation to serve all of the country and AT&T has that special burden of geographic rate averaging which it has to carry.

And that is why it is vital that we visit soon the question of providing AT&T with the ability to come in with pricing plans that give it more flexibility so it can offer those. And a point that I made earlier which I will make, since you were not here, is that this is the only way in the near term we can see that people in rural areas will enjoy the advantages of competition.

That is, if AT&T makes a competitive response because of the competition in the urban areas of the other companies, we require them in their competitive response where they are cutting rates to provide that to every AT&T subscriber, and that in the near term will provide a benefit from this competition to rural subscribers.

Senator GORE. Well, I appreciate your statement that you are opposed to any effort to deaverage tolls on the part of AT&T and I am glad that we are not going to see any such proposal entertained.

I have some additional questions on end user charges. I do not want to go into that whole thing. We have had many exchanges on that, but I do have some questions about some proposals that have been presented to the FCC to use the 35-cent add-on to prevent bypass by large business users, and I want to know why the Commission has failed to act on that or any other such proposal.

Do you want to respond to that just briefly?

Mr. FOWLER. We are working through the Joint Board right now on that. The reason for ever proposing the 35-cent surcharge was, simply to try to keep everybody's local telephone bill as low as possible.

That 35-cent maximum might be seen as a kind of an insurance premium that everybody would have to pay in order to cushion them from much larger increases in local phone rates and that is the whole idea behind that. It may not be needed in some markets.

Senator GORE. But there are plans pending. At least one Bell company has proposed a specific plan to use this to prevent bypass by large companies and the FCC has not acted, and I am wondering why.

Mr. FOWLER. The Joint Board is first going to act on that. I think they are going to file. As I understand it, we are going to have the Joint Board consider that, which is a Federal-State body, but I do not think it has been filed yet.

Mrs. DAWSON. Senator, the Joint Board certainly is looking at proposals to allow carriers with the consent of their State commissions, to file optional tariffs that would allow them to prevent bypass. But the one proposal we have had before the Joint Board did have some aspects to it that would not hold harmless the deaveraging of rates.

So, therefore, we said that there needed to be some improvements and some changes made and that we would review it when they returned it. So your concern about averaging was our very reason for asking them to revise their proposal.

Senator GORE. Very good.

Mr. Chairman, in closing, I would just like to say this is perhaps the last occasion on which Commissioner Rivera will be before the committee and I just want to take this occasion to state in a personal way how much respect I have for his service on the Commission. I think he has been an outstanding advocate of many ideas and proposals that I believe in very strongly, and we are going to miss you a great deal, and I wish you very well as you go on to other pursuits.

But I, for one, am really going to miss you and I appreciate your service.

Thank you, Mr. Chairman.

Senator GOLDWATER. I have quite a few questions but in the interest of brevity I am going to submit them and you can answer them at your leisure and also Senator Hollings has some questions and in his customary desire for expeditious action has agreed to submit his.

If there are no more questions for you all, you may leave, and I will tell you what my plans are, if nobody objects. I would like to call the representative from Justice, who I understand wants to submit his testimony for the record, and if that is what he wants to do and there are no questions, then we will go over and vote when the vote is called, and then when we come back we will call the panel of Charles Brown, Bill McGowan, and Ted Brophy.

So thank you very much for your testimony.

Senator FORD. Mr. Chairman, did I understand you, we were just going to submit Justice's statement and have no questions?

Senator GOLDWATER No. He has asked if he could submit his statement.

Did you want to ask questions?

Senator FORD. Fine, I just have one question.

Senator GOLDWATER. We have not even gotten to him yet.

Senator FORD. I apologize, Mr. Chairman.

[The following information was subsequently received for the record:]

STATEMENT OF JAMES H. QUELLO, COMMISSIONER, FCC

For the record, I would like to submit the following summary of Commission actions and describe some of the existing conditions that tend to promote OCC competition.

I started to list some of the items in reply to Chairman Danforth's question to all commissioners at the September 11 hearing. However, my reply went beyond Chairman Danforth's specific question and I did not complete the summary.

My completed summary of conditions and actions that encourage OCC competition are:

1. The Commission has guaranteed all interexchange carriers access to local exchange facilities at favorable rates to all non-AT&T carriers until equal access is instituted. The FCC has provided a 55% discount which should more than adequately compensate for inferiority of access. (This 55% discount results in AT&T rates remaining higher and indirectly penalizes rural and low volume users.)

2. The Commission has imposed no obligation to serve on the OCC's, and thus they are free to serve any markets of their choosing which means serving markets of highest potential. AT&T is obligated to serve all markets including low volume, unprofitable rural areas.

3. The OCC's are free to price their service at will while AT&T must abide by the cumbersome FCC tariff process which requires public comment and provides competitors with an opportunity to delay.

4. OCC's are allowed faster business depreciation without FCC regulation while AT&T depreciation rates are set under rules of a regulated monopoly which are much more stringent than those of the IRS. This is a decided business (cash flow) advantage.

5. Because of faster depreciation and entrance into a relatively new business, the OCC's should have newer more efficient equipment reflecting the latest state of the art.

6. The FCC recently required pro-rate allocation of customers not making a long distance choice—instead of automatic default to AT&T that was in place.

7. While AT&T must still operate under Computer II restrictions, the OCC competitors are free to operate as they please without any separate subsidiary requirements.

I am listing the above to demonstrate FCC concern for fair treatment of OCC's and for development of a competitive marketplace.

While the FCC must, of course, be open minded for any new developments in this area, I would like the record to reflect my present personal belief that efficiently managed OCC's should be able to compete in the future marketplace after installation of equal access and discontinuance of a 55% discount subsidy. In a competitive marketplace success cannot be assured for all competitors. I believe the FCC should do all in its power to provide a level playing field for the ultimate goal: maximum benefit to consumers and reasonable opportunity for business expansion and growth.

QUESTIONS OF SENATOR GOLDWATER AND THE ANSWERS

Question. Do you believe the long distance market is competitive?

Answer. It is clear that today the long distance market is not fully competitive. AT&T continues to possess market power, and as a result it is still fully regulated under the Communications Act as a dominant carrier. However, it is fair to describe the long distance market as in a state of transition toward full competition, at which point AT&T would no longer possess sufficient market power to raise and sustain prices at monopolistic levels. The competitive process by which we can reach that point is firmly established and is being carefully monitored by the Commission.

Question. Why hasn't the FCC finished the inquiry it started in 1983 with the state of the market and the long-run regulation of AT&T? Do you think it would be

foolhardy to conduct a transition to competition without first developing a comprehensive plan for that transition?

Answer. Docket 83-1147, the proceeding referenced here, is a very broad, and perhaps a bit premature, inquiry into the future treatment of AT&T. The comments and information received in the docket are interesting and should prove useful later on when the Commission faces decisions on AT&T's loss of market power. Experience has taught us that an industry as dynamic as telecommunications does not lend itself to neat regulatory blueprints. Thus, at this stage, we believe long-term predictions on how the various markets will develop may not be particularly useful. Today the public interest is best advanced by more narrowly focused proposals that can be more readily debated, scrutinized and resolved.

Question. Do you believe that ensuring effective long-distance competition is an important national goal?

Answer. The FCC has been and will continue to be committed to ensuring effective long distance competition. This is because we believe that marketplace competition maximizes consumer welfare to a greater degree than regulation. In general, competitive markets are driven by economically relevant information and respond to consumer demands more effectively than even the most efficient government bureaucracies. Thus, where feasible and consistent with the Communications Act, effective competition, which will bring innovative goods and services as well as lower prices, is clearly in the best interest of the public.

Question. Chairman Fowler, your testimony indicates that AT&T's competitors have grown. Have they grown since the transition to equal access began, or was most of their growth before the transition began? Have new companies entered the market since the equal access transition began?

Answer. The transition to equal access began in 1984. As shown in the charts attached to my testimony, the number of customers served by Sprint increased by 40% during 1984 and the number of customers served by MCI increased by 35% during the last nine months of 1984. Although both carriers are actively adding new customers as the transition to equal access continues, we do not yet have any data for 1985 growth rates. Smaller carriers have continued to enter the industry. We cannot provide an exact count of the number of new carriers since we have relieved them of all reporting requirements.

Question. Do you believe that prior to the conversion to equal access in September 1986, AT&T should be permitted to price its services below what it pays for local connections, that is, below the tariffed rates for interstate local exchange access?

Answer. The Commission continues to require dominant carriers to price their services at or above their relevant costs, including access costs, whether or not equal access has been achieved. This does not mean, however, that the Commission requires every rate element within a service category to fully recover relevant costs. Rather, the Commission only requires that the service category as a whole recover the relevant costs. Thus, for instance, the Commission does not require AT&T's night/weekend MTS rates to be priced above the cost of access charges since the MTS category as a whole is priced above AT&T's costs. Any other result might promote the inefficient utilization of the network to the detriment of all ratepayers.

Question. When should the FCC lessen its regulatory scrutiny of AT&T's rate reductions? Is there more harm in deregulating too quickly than in deregulating too slowly?

Answer. The Commission has the statutory mandate to promote the wide availability of efficient and reasonably priced telecommunications services throughout the nation. The Commission believes that competition in the telecommunications market and the reduction of regulatory burdens on carriers are the best means of decreasing prices and increasing consumer choices. Therefore, the Commission should lessen its regulatory oversight of AT&T rate reductions as soon as it believes the market is sufficiently competitive that anticompetitive practices can be effectively remedied through general antitrust laws, rather than through Commission regulation of competitive markets. There may be equal, although different, types of harm if deregulation takes place too quickly or too slowly. Deregulation that occurs more slowly than is necessary can harm the economy by delaying price cuts and introduction of innovative services. Deregulation that occurs too quickly, on the other hand, can risk the impairment of competition if the market is not sufficiently developed. The Commission intends to deregulate the telecommunications market by taking carefully crafted steps as we receive evidence that the marketplace is developing sufficiently to accommodate the reduced regulation.

Question. When should AT&T and its competitors pay the same price for local connections?

Answer. The Commission has established premium and non-premium rate categories for access services provided by exchange carriers during the transition to equal access and provided for a 55% discount for non-premium services. Our access charge rules provide that the non-premium discount is phased out on an end-office-by-end-office basis as equal access becomes available to AT&T's competitors.

The OCCs have recently asked that we require the BOCs to phase-out the discount on a LATA-wide basis. As you know, we are currently examining the OCC request and have not yet made a final determination. We believe it is clear, however, that the rates both AT&T and its competitors pay for access to the local exchange should be cost-based with each paying for what they receive.

Question. Do you believe AT&T's competitors are having a hard time competing? Why?

Answer. Striving to acquire and keep customers is precisely what it is about competition that redounds to consumers' advantage. Competition that is easy on the competitors would not be competition at all and would not benefit consumers. The FCC is dedicated to making the competitive process work. We cannot, however, confuse our commitment to competition with the concerns of any particular competitor. The competitive process is designed to achieve a level playing field where all competitors are equally free to succeed or fail on their own talents, ingenuity and efforts according to the wishes of American consumers. It is welfare of consumers, not individual competitors, that must remain the touchstone of FCC policy-making.

Question. What can be done to ensure that competitive long-distance service options are available in rural America?

Answer. Today, AT&T is the only long-distance carrier fully regulated under the Communications Act of 1934. Thus, only AT&T is subject to the statutory obligation to serve the public in all areas of the country. New competing carriers are free to target only the most lucrative markets. Because rural subscribers are generally in more high cost areas most alternative carriers have not yet sought out the rural market. Thus, in the near term an important way rural America (generally AT&T's customers) will see the benefits of developing competition is through price cuts, new services or other competitive responses from AT&T. This is an important reason why the Commission encourages innovative competitive responses. To assure that rural America benefits from these competitive responses the Commission requires that all such competitive responses are provided throughout the country on the same terms and conditions.

QUESTIONS OF SENATOR PRESSLER AND THE ANSWERS

Question. You issued a public notice on June 17, 1985, regarding the OCC pleading. What procedural steps are now required before you can reach a conclusion as to the merits of the arguments placed before you? How long do you think the entire process will take?

Answer. The Public Notice established a pleading cycle for the OCC petition. Comments were filed on July 22, 1985, and reply comments were filed on August 6, 1985. The staff of the Common Carrier Bureau is carefully studying these pleadings and will thoroughly evaluate the various concerns. The staff will then make a recommendation whether the Commission should initiate a rulemaking concerning the actions requested by the OCCs with respect to the equal access conversion process. The Commission is committed to expedited action on this request. Commission action on this item can be expected before the end of the year.

Question. Do you believe that the provision of (technical) switching alone will provide AT&T competitors "equal access" to the marketplace? Or does true equality involve economic and marketing factors as well as technological factors? If so, shouldn't the Commission be working in a timely manner to develop a more realistic definitions of "equal access"?

Answer. The Commission has concurred with the approach taken in the Modification of Final Judgment (MFJ) in the AT&T divestiture case. The MFJ defines equal access as access which is "equal in type and quality" to that provided to AT&T. The court found that minor variations in technical quality would be permitted so long as deviations are imperceptible to customers. While permitting these minor technical variations, the MFJ requires that the same general service features be available to all interexchange carriers upon conversion to equal access. These service features include, among others, equality in the number of digits that must be dialed, access from rotary-type phones, answer supervision to enable the interexchange carrier to know when a call has been completed, and the provision of information necessary to bill customers. These service features correspond to an access service called Feature

Group D, which is becoming available to all carriers according to the scheduled filed with the Department of Justice.

The question of whether certain additional factors, such as the availability of tandem switches and OCC marketing concerns and costs, should somehow be made part of the equal access definition is raised in a recent petition filed by four OCCs. We are carefully evaluating the pleadings on the OCC petition to determine if a change of course is warranted and have not yet made a final determination.

Question. Do you believe there currently is effective competition in the long distance market? Why?

Answer. It is clear that today the long distance market is not fully competitive. AT&T continues to possess market power, and as a result it is still fully regulated under the Communications Act as a dominant carrier. However, it is fair to describe the long distance market as in a state of transition toward full competition, at which point AT&T would no longer possess sufficient market power to raise and sustain prices at monopolistic levels. The competitive process by which we can reach that point is firmly established and is being carefully monitored by the Commission.

Question. What do you believe is necessary before a competitive marketplace can exist? What is the basis for your answer? Do you have studies to support your view?

Answer. The essential condition for a competitive marketplace to exist is that no one firm or group of firms has the power to either raise price above a competitive level or exclude the entry of alternative suppliers. A key aspect of a truly competitive market is open entry and competition, including elimination of government imposed restrictions on either the ability of firms to enter or lower their prices. A condition for the absence of market power by a firm or group of firms is that alternatives exist such that any attempt to charge an excessive price will result in a rapid reduction in market share.

In the telephone industry the specific conditions necessary for a competitive interexchange marketplace includes access on equivalent terms and conditions to the local exchange telephone companies facilities, and the presence of multiple viable interexchange actual and potential competitors.

In reaching this conclusion I have relied on the general teachings of the courts and commentators that have addressed market power in an antitrust context, as well as economic studies. Useful summaries of the state of knowledge in this area in general and with respect to telecommunications include:

1. Gerald W. Brock, "The Telecommunications Industry: The Dynamics of Market Structure" (Cambridge, Mass: Harvard University Press, 1981).

2. William M. Landes and Richard A. Posner, "Market Power in Antitrust Cases," 94 "Harvard Law Review" 937 (1981).

3. Laurence Anthony Sullivan, "Handbook of the Law of Antitrust" (St. Paul Minn: West Publishing Co., 1977).

Question. If competition fails during the period, do you believe that many companies would desire to enter the telecommunications field in 1990? And if so could they become effective competitors and how?

Answer. The possibility that competition will fail during this period is so remote that any response here can only be made in a highly speculative context. If it did, the evidence would then indicate that prospects for successful entry absent changes in technology or more efficient industrial organization were not bright. I would then speculate that few would wish to enter the telecommunications marketplace.

I must emphasize, however, that even if your question were limited to the long-distance marketplace, there is no likelihood that any such event will occur. I would also stress that many industries experience failures of individual competitors and that this is not at all a signal that competition has failed but, rather a signal that it is working. The competitive process rewards efficiency and penalizes inefficiency.

Question. Does it, or should it, concern you that none of the other common carriers, OCCs, is making any money on its long distance service under existing policies? (While MCI was profitable, it is my understanding that that profit did not come from the provision of its service.)

Answer. During 1984, both MCI and Sprint earned operating profits. That is, revenues from communications services exceeded the expenses of providing those services, before adjusting for interest, taxes, and extraordinary items. Although financial results for 1985 are not yet available, the fact that both carriers are continuing to invest hundreds of millions of dollars in expanding their facilities indicates that they expect the business ultimately to be profitable. Because many smaller carriers are privately held and the FCC no longer requires competing carriers to file financial data, we do not know which of the other carriers are profitable and which are not. In general, however, the continued rapid growth of competitors seems to indicate that entrepreneurs believe that profits can be made. Thus we are not in the

situation where none of the other common carriers is making money. Should that situation arise in the future, the Commission would have to determine whether the situation was caused by external economic factors (there are periods of time when, in most competitive industries, no firm makes profits); whether the lack of profits was due to conditions internal to the industry but not related to Commission policies (for example, a general overexpansion of capacity); whether the condition was due to Commission policies that need to be corrected. But the Commission's primary focus must always be on protecting consumers rather than on protecting industry profits. And in a competitive industry, it must be expected that some firms will prosper and some will fail.

Question. In your view, what conditions should exist in the long-distance market prior to AT&T being deregulated?

Answer. In order for ATT-Communications to be completely deregulated, we believe that it must possess neither the ability to elevate and sustain its prices above a competitive level, nor the ability to exclude competition in any section of the country. At the same time, as competition develops the FCC has a continuing duty to review all of its regulations in light of changing circumstances to ensure that their benefits still exceed their costs, and to make whatever adjustments are necessary to further the public interest.

Question. Some people believe that even if ATT had no real competitors, the mere possibility of competition is sufficient to ensure that ATT acts in the public interest. Do you subscribe to that view?

Answer. Certainly potential competition always provides some check on anticompetitive behavior. The question is how effective a check. In order for competitors to provide a sufficiently effective check on ATT (or any other firm), we believe competition must not be a mere theoretical possibility without actual facilities, employees, finance, customers and experience. All are available in significant quantities in today's telecommunications marketplace.

Question. It appears that you have adopted a new tariff review concept: allow the tariff to go into effect and see if it is anticompetitive. How do you recreate competition if you are wrong? Don't you believe that if serious questions exist as to the impact of any action or tariff on competition, that during this sensitive transition period it is best to err on the side of safety?

Answer. The Commission does not follow a policy of permitting tariffs to take effect and waiting to determine the anticompetitive effects of the offering. When a carrier submits tariff revisions, the Commission evaluates the proposed tariff changes and makes a determination whether the tariff is clearly unreasonable, clearly not unreasonable, or whether there is uncertainty with respect to the effects of the proposed changes. If the tariff is clearly unlawful on its face, it is rejected. If it is clearly not unreasonable, it is permitted to go into effect. If there is uncertainty as to the impact of the proposed offering, the Commission often investigates the offering and makes a judgment whether the public benefits to be achieved from the offering, e.g., lower prices, outweigh the potential damage to ratepayers or competition. The Commission must then use its judgment to determine whether to suspend the offering. The Commission's recent action in suspending and ultimately finding unlawful the PRO America tariff proposed by AT&T is an example of the application of these tariff review principles. In addition, the Commission often monitors actual operating results of offerings which have the potential to harm competition and has acted to require changes in the offering if anticompetitive effects become evident. This monitoring should be sufficient to protect competition. It is important to note that, as with any competitive market, not every competitor currently in the interstate long distance market can be expected to survive, or to continue to operate in the same fashion. The Commission does not believe its responsibility is to protect individual competitors. The commission is committed to implementation of a fair competitive environment, whereby consumer welfare—the FCC's primary concern—is enhanced.

QUESTIONS OF SENATOR HOLLINGS AND THE ANSWERS

Question. Well over a year ago the Commission began a general inquiry to determine how to regulate AT&T in the future. The purpose of this inquiry was to establish an overall strategy for deregulation and avoid ad hoc decisions. Where does this inquiry now stand?

Answer. Docket 83-1147, the proceeding referenced here, is a very broad, and perhaps a bit premature, inquiry into the future treatment of AT&T. The comments and information received in the docket are interesting and should prove useful later

on when the Commission faces decisions on AT&T's loss of market power. Experience has taught us that an industry as dynamic as telecommunications does not lend itself to neat regulatory blueprints. Thus, at this stage we believe long-term predictions on how the various markets will develop may not be particularly useful. Today the public interest is best advanced by more narrowly focused proposals that can be more readily debated, scrutinized and resolved.

Question. If AT&T were deregulated tomorrow and decided to increase its rates dramatically, what would happen to ratepayers?

Answer. This question raises a hypothetical that will not come to pass. If it did, ratepayers would be dealing with a totally deregulated carrier which could theoretically raise and sustain prices above competitive levels. This is precisely one of the results the FCC is working to avoid as we move to a more competitive environment. Thus, we continue to treat AT&T as a dominant carrier and subject its activities and services to full regulatory scrutiny. This is in contrast to its competitors who are free to develop all products, services, pricing plans, etc., free of regulatory involvement. As guardians of competition, however, we cannot ignore the fact that full competition must be achieved in a series of steps. Responsible regulatory responses must reflect the gradual changes in the competitive posture of the marketplace.

Question. The Commission is now considering a proposal to allow AT&T greater flexibility in pricing. Could you please explain this new proposal? Will it still require AT&T to file full cost support and other information as is now required? What opportunity will outside parties have to comment on each of these new optional calling tariffs?

Answer. In a notice of Proposed Rulemaking issued on January 9, 1985 the Commission proposed to adopt guidelines governing MTS optional calling plans submitted by dominant carriers. The Notice tentatively concluded that greater flexibility should be provided to dominant carriers in fashioning optional calling plans so that consumers in all areas of the country could reap the benefits of lower prices and more choices resulting from a more competitive marketplace. The Notice contains several proposals. First, it proposes to require that any plan be designed to increase a carrier's net MTS revenues. This test is designed to ensure that optional calling plan prices are not set at predatory levels or force other customers to fund the competitive offering. Second, another proposed guideline prohibits the plan from containing restrictions on resale, customer selection or shared use to prevent unreasonable discrimination. Third, an alternative proposed guideline would require that a plan be reasonably projected to increase the contribution to overhead cost recovery. Fourth, another proposed guideline is to establish zones of flexibility where rates could fluctuate between minimum and maximum levels. Fifth, a proposed guideline would permit multipart pricing. (An example of multipart pricing is where there is a flat monthly charge and an additional charge based on usage.) Sixth, another proposed guideline would permit minimum monthly charges or subscription charges as long as they are reasonably related to the costs of providing the service. The commission expects to act on this Notice in the very near future.

The Commission continues to treat AT&T as a dominant carrier. As such, the Commission will continue to require that AT&T fully cost justify any optional calling plan it submits. Under the Commission's Rules any interested party may file petitions to reject, suspend or investigate a tariff proposal containing their objections to the proposed tariff. This provision would be applicable to optional calling plan proposals just as with other types of tariff revisions.

Question. While the FCC has been, for the most part, decreasing AT&T's interstate rates, AT&T's intrastate rates in a great many areas have been increasing. It seems to me there is less competition in the area of intrastate service, particularly in rural areas, which would give AT&T less incentive to lower its rates there. Is the FCC looking into this situation? Do you believe cross-subsidies from intrastate to interstate toll may exist?

Answer. Intrastate toll service is regulated by state public utility commissions rather than the FCC. It is true that there is currently less competition in many intrastate markets than in the interstate market. However, we are pleased to see more states moving to promote intrastate competition. We do not see any evidence, however, of monopoly profits in intrastate service or of cross subsidies from intrastate service to interstate service.

The expense and revenue data filed with the FCC by AT&T relate primarily to their interstate operations. However, we also receive similar data for the total operations of AT&T Communications. By comparing the two, it becomes clear that in 1984, AT&T's intrastate operations were, at best, marginally profitable. The reason why intrastate operations are less profitable than interstate operations lies in the

fact that revenues are highly dependent on distance while costs are not. A short distance toll call requires very nearly as much expense to produce as a much longer call: the expenses associated with recording, billing, collection and switching are very similar regardless of the distance the call is transmitted. The primary additional expense of a longer distance call is simply transmission over a longer distance, a relatively minor part of total costs. Under the current rate structure, revenues rise substantially as call distances increase, and longer distance calls are substantially more profitable than calls carried a short distance. Because intrastate calls tend to be carried much shorter distances than interstate calls, the intrastate business tends to be less profitable. Thus, while we are constantly monitoring for cross-subsidies of any form, given present rate structures, we do not see that intrastate calls are subsidizing interstate calls.

Question. Do the long distance competitors own all their own facilities?

Answer. No. ATT-Communications leases some of its interexchange facilities from the regional holding companies, subject to the shared network facilities agreements that were part of the divestiture agreement. These facilities-sharing arrangements are, relatively rapidly, being phased out. All of the interexchange carriers obtain substantial local distribution facilities from the local exchange companies under federal and state access tariffs.

In addition, all of the carriers, other than ATT-Communications, lease portions of their networks from ATT. The level of the competitors' dependence on ATT varies. MCI has announced a construction program which will enable it to serve every LATA in the United States by 1986 with its own facilities.

Furthermore, ATT-Communication's rivals also share facilities among themselves by either contract or by acquiring service under tariff. For example, US Telecom and GTE Sprint recently announced a major facilities-sharing arrangement that would enable each to share portions of the other's network, thus avoiding or enabling deferral of some major construction outlays.

Question. How important is this factor to the future of competition in this industry?

Answer. The ability of firms to rely upon resale or sharing of others' facilities enhances the prospects for competition in the telecommunications industry. Competitors can use each others' facilities to fill gaps in their construction programs. They can also offer their customers a wider geographic scope than would be permitted by their own networks.

To be sure, if the only competition was by resale of ATT facilities, the long run prospects for competition would be limited to the (useful) role of limiting price discrimination through arbitrage. However, this is far from the case.

Question. There has been a lot of talk about AT&T's market power, and Mr. Fowler mentions it in his statement. Rather than talking in gross terms about AT&T's market power, could you break it in to particular services? What about in the area of establishing network standards? For example, where does most of the software to ensure equal access come from?

Answer. AT&T's network of transmission and switching facilities is used to provide both private line services and switched services. Because different services can be provided over the same facilities, it is difficult and not very meaningful to break out AT&T's market power on a service-by-service basis. It is clear, however, that AT&T's overall market power with respect to services is far greater than its market power in the field of equipment, where AT&T's market share has fallen substantially.

Many network standards were established by AT&T prior to divestiture and are simply being maintained by the operating companies. In fact, many of the service quality measurements represent "products" developed by Bell Labs. These include the Service Evaluation System II and its associated reports and the Telsam customer perception surveys as well as the transmission measurement plan. Bell Communications Research theoretically can recommend changes to existing standards and measurement programs, and the operating companies can do so themselves, but there appears to be little movement towards such change.

The process of establishing network and service standards for the future is more open and diffused than in the past. Many of these are being established in domestic voluntary standardization bodies that use fair and open procedures, such as the Exchange Carriers Standards Association, in which carriers, manufacturers and even users can and do participate. Others are being established in international bodies such as the International Standards Organization and the International Telecommunications Union (ITU) and its CCIR and CCITT suborgans. AT&T is a participant in these, but so are the Bell Operating Companies (directly and through Bell Communications Research) and other interested parties.

The software to provide equal access comes, in most cases, from the company that manufactured the electronic switches being modified to provide equal access. Thus, software updates called "generics" are being supplied by AT&T technologies for switches originally manufactured by Western Electric. Similarly, Northern Telecom and other vendors are producing software for switches not produced by Western Electric.

Question. You appended to your testimony a list of firms in the long distance market. How many have entered since divestiture? How many have exited?

Answer. The list of firms attached to my testimony was a list of some 250 firms that, although not required to do so, had chosen to file their rates with the Commission. We do not know how many other firms were providing service but had not filed their rates. We do not regulate smaller companies because they do not possess market power and we do not wish to impose unnecessary burdens on them. Thus, we have no correct counts of the number of firms entering the industry, leaving the industry, or serving at any particular time. It is clear that the number of firms is continuing to increase. We are currently developing better means of acquiring information on the number of firms providing service without imposing reporting requirements on otherwise unregulated carriers.

Question. The FCC collects much information about the long distance market. What don't you collect that you believe you need to properly oversee this industry?

Answer. The FCC collects a great deal of information about revenues and expenses from carriers that are regarded as dominant and that we continue to regulate, basically AT&T and exchange carriers. We receive this information in the tariff process, in the auditing process, and in the form of periodic reports. We believe that we receive all the information currently required to perform our basic regulatory functions, including protecting ratepayers from rates that are not justified in terms of the underlying costs and preventing anti-competitive cross subsidies. The FCC receives very little information from carriers that do not possess market power. We have generally exempted these carriers from regulatory burdens including our periodic reporting requirements. We realize that reporting requirements imposed on small firms require those firms to incur costs that are not necessary. Thus, we have refrained from collecting information that, while interesting, is not essential to our regulatory functions.

Question. There seems to be much confusion about what equal access means. What is the Commission's definition?

Answer. The Commission concurs with the definition of equal access adopted in the Modification of Final Judgment (MFJ) settling the ST&T antitrust case. Equal access means that all long distance carriers receive access that is "equal in type and quality" to that provided to AT&T. Equal access has not been defined in precise technical terms. Instead, the characteristics of equal access have been described in terms of a listing of general features:

- a—Dialing parity
- b—Rotary dial access
- c—Network control signalling
- d—Answer supervision
- e—Automatic calling number identification
- f—Carrier access codes
- g—Directory services
- h—Testing and maintenance of facilities
- i—Provision of information necessary to bill customers
- j—Presubscription

Certain technical aspects of access (such as blocking probabilities, attenuation, channel noise, error rates, and echo) could be quantitatively measured and expressed in physical measurements. In terms of these technical characteristics, however, the access provided to AT&T is not precisely the same throughout the country. Depending on the type of wires and switches used, there are minor variations from location to location. Hence, exact technical duplication of the access provided AT&T is infeasible. Thus both the FCC and the Court overseeing the consent decrees have decided that minor variations in technical quality are permitted so long as the deviations will be imperceptible to all customers.

Question. Has the FCC conducted any surveys or received any information that the user is confused by the equal access process?

Answer. The Commission has received a few hundred letters from the public with questions or complaints on equal access. Most of these have been resolved by sending the correspondent a copy of the Commission's fact sheet on the equal access conversion process. The remainder are handled by forwarding the letter to the appro-

priate carrier as an informal complaint under Section 208 of the Communications Act. The letters in this second category currently are in various stages of resolution.

Question. Who provides total end-to-end service in the telecommunications market?

Answer. Long distance telecommunications typically requires the cooperation of several carriers, none of which provides end to end service. Most calls originate and terminate using the facilities of local telephone companies, with the long distance transmission being handled by an unaffiliated long distance carrier (either AT&T or one of its competitors). The Bell Operating Companies, however, are able to provide end-to-end service for shorter distance toll calls that do not cross a LATA boundary. In addition, some firms have constructed private telecommunications systems that "bypass" the facilities of common carriers and thereby provide themselves with end-to-end service. However, most long distance service continues to be provided using access purchased from local operating companies rather than being provided from end-to-end by a single carrier.

Question. What services doesn't AT&T's subsidiary, ATTIS, provide?

Answer. We have forbore from regulation of ATTIS just as we forbear from regulating other non-dominant carriers. Thus, ATTIS may provide the services it wishes except for regulated telecommunications service. Regulated services are provided by AT&T Communications (the arm of AT&T still subject to full regulation). While ATTIS may purchase and resell such services, it may not provide them directly.

Question. Many of the subsidiaries the FCC ordered to be created have recently incurred substantial losses. ATTIS reported a loss of \$432 [million] for 1984. Does the FCC collect information on the finances of all of these subsidiaries? Who pays for these losses, and how do we ensure the ratepayer doesn't?

Answer. The FCC has reviewed the capitalization plan of each separate subsidiary in order that assets financed by ratepayers were not transferred out from under our regulatory scrutiny without adequate compensation. We also monitor dealings between AT&T and its subsidiaries to ensure that cross subsidies do not flow from one to the other. With ratepayers protected by these steps, any losses incurred by separate subsidiaries must be borne by AT&T's stockholders.

Question. The Commission has stated that separate subsidiaries impose unjustifiable cost inefficiencies. What studies has the Commission undertaken to support this claim? Do you have detailed evidence?

Answer. It is, of course, difficult to quantify precisely the cost inefficiencies associated with the imposition of a separate subsidiary requirement. AT&T has estimated that the separate subsidiary requirement for the provision of customer premises equipment imposes over \$1 billion a year in additional costs on its operations resulting from the duplication of personnel and facilities. Moreover, it is likely that restrictions on information flows within AT&T and the lost economies of scale resulting from separation impose even more substantial costs upon AT&T. In any event, the divestiture of the Bell Operating Companies by AT&T, which eliminated AT&T's control over local exchange facilities, the highly developed state of competition in the CPE marketplace, and the growing competition in the inter-LATA services market, have substantially reduced the benefits obtaining from the separation requirements. AT&T's market share of new PBX shipments fell from 45% in 1980 to between 19-26% in 1984, and its share of new key systems shipments fell from 56% to between 25-33% over the same period. One result of AT&T's market position in new shipments is a significant erosion in its share of the U.S.-installed base of key systems and PBXs. Estimates indicated that, in 1980, equipment provided by AT&T represented 75% of the U.S.-installed key system base and 61% of the U.S.-installed PBX base, and that by 1984 AT&T's market share had declined to 57% of the key systems base and 45% of the PBX base. As a result, we have concluded that, on balance, the costs of continuing to require structural separation for AT&T's provision of CPE now outweigh the benefits.

Question. Does the Commission yet have in place an adequate accounting system that can tell cost of service and that can detect cross-subsidies from regulated to unregulated ventures.

Answer. The Commission currently has in place the requirements established in the Fifth Report and Order in CC Docket No. 81-893, outlining the accounting principles to be followed by carriers that are not subject to structural separation requirements. The Commission also has in place several accounting plans designed to separate joint and common costs between AT&T Information Systems and AT&T Communications for those joint activities that the Commission has previously authorized. Finally, the Order in CC Docket No. 85-26, allowing AT&T to provide customer premises equipment free of the structural separation requirements estab-

lished in the Second Computer Inquiry, requires AT&T to file an acceptable accounting plan to allocate joint and common costs between regulated and unregulated activities. The plan filed by AT&T must contain specific account and allocation information, and the Commission will review the plan prior to the implementation of relief. The Commission has also required that AT&T's operations under the plan be subject to a yearly audit by an independent accounting firm, at AT&T's expense.

QUESTIONS OF SENATOR INOUE AND THE ANSWERS

Question. Some of AT&T's competitors contend that the promise of competition in the long distance market is threatened by government policies which fail to recognize the many advantages AT&T has over its competitors due to its prior status as a monopolist, and that these advantages must be counter-balanced by appropriate regulatory action.

Some of these contentions which AT&T's competitors feel require "appropriate regulatory action" are:

- AT&T's former monopoly position give it alone the benefit of comprehensive, pre-divestiture usage information. AT&T retains access to current information on 90 percent of all long distance traffic.
- This usage data which only AT&T possesses gives it the exclusive ability to design and market programs which are based on the precise needs and habits of specific customers. Offerings such as "Reach Out America" and "Opportunity Calling" are examples of this ability.
- This information also allows AT&T to design its facilities and systems with much greater accuracy than its competitors. Knowledge of the amount of traffic from each local telephone office enables AT&T to order the exact amount of facilities required for connection to each office.
- Competing interexchange carriers cannot purchase unlisted names from the Bell Operating Companies. The only information commercially available is names, addresses, and phone numbers in the directories. In the absence of the type of information AT&T possesses, OCCs cannot market with the same success as AT&T.
- Unable to forecast traffic demands with the same precision as AT&T, the competing carriers risk severe penalties in efficiency through overforecasting and in service quality through underforecasting.
- In an analogous situation, the Federal Communications Commission has ordered Comsat to make public any information it possesses as a result of its monopoly relationship with Intelsat and Inmarsat if that information is used for commercial ventures.
- For all practical purposes, AT&T continues to be the only long distance company able to provide 800 service, 900 service, coin calling from payphones, and automated credit and service.
- Duplication of these operating systems will require the other common carriers to expend years of development effort and tens of millions of dollars. AT&T will remain the only full service long distance carrier long after equal access is phased in.
- AT&T's de facto monopoly over these operating systems allows it to compensate for low rates in urban areas by charging higher rates than necessary in rural areas.
- Since these assets were developed in a monopoly environment and funded by monopoly ratepayers, the consumer should receive the benefits from opening the services to competition. As was done with AT&T's patents in the 1956 Consent Decree, these systems should be made available to all competitors.

Would you please comment on each of these alleged advantages?

Answer. These are issues that have been raised in the recent OCC petition for rulemaking on competition in the interstate long distance market. In addition, issues related to the provision of 800 Service have been raised in a petition filed by the one of the BOCs. FCC staff is diligently studying each of these issues to determine if a change of course by the Commission is warranted. Thus, at this time we are unable to respond to some of the specifics of the request. However, as indicated in the prepared testimony to the Committee in addressing these concerns, it is important to recognize that the advantages that the OCCs contend AT&T possesses must be balanced against the advantages the OCCs have by virtue of their status as nondominant carriers and new entrants.

First, while AT&T possesses a variety of data on their customers' usage, there is no reason to believe that this is a unique attribute. The OCCs possess usage data on

their customers that is unavailable to AT&T and some OCCs have developed these data over several years. Second, the OCCs are not rate regulated entities, and therefore are free to develop and quickly introduce their own special rate plans without regulatory scrutiny. AT&T, in contrast, must file tariffs and accompanying cost support data with the Commission, and have its proposals subject to competitors' petitions. Third, the OCCs have no nationwide obligation to serve customers. The OCCs are free to target areas that are less expensive to serve and where they are likely to find the most or the most desirable customers. Fourth, in this regard, AT&T is required to use geographically averaged rates for its services, which results in lower prices for high-cost areas (including many rural areas) than would otherwise be the case. The OCCs can charge deaveraged rates. If its competitors perceive that AT&T's rates in certain areas are higher than necessary they can move into those areas and offer lower-priced services. Fifth, the OCCs, in engineering their networks, are taking advantage of new lower cost technologies that provide the most up-to-date transmission capabilities. Finally, with regard to marketing, there is some debate whether AT&T has an inherent advantage. While it is larger than the OCCs, it is subject to regulatory restraints in designing marketing responses. If there is one aspect of telephone competition where ingenuity can contribute to a new entrant's success, it is marketing. In this industry, as in others, size is no guarantee that effective marketing strategies will be adopted.

The Commission recognizes the importance of prompt and fair review of the matter raised by the OCCs. The Commission will act in an evenhanded manner to assure that the competitive process remains vigorous and healthy. Action on the OCC petition can be expected before the end of the year.

Question. Some critics believe that the deregulation of AT&T has been "premature" and places the development of competition in "serious jeopardy." Specifically, these critics allege that:

(a) The OCC's *Second Computer Inquiry* separation requirement limited AT&T Information Systems ("ATTIS") to providing computer-RELATED "enhanced" services and customer premises equipment. This was done in the belief that unregulated resale of "basic" services purchased from an affiliated entity would permit AT&T to evade regulation. Recently, however, the FCC has given AT&T the ability to avoid regulation by permitting it to sell its regulated services to ATTIS for resale on a non-regulated basis.

(b) The FCC has permitted revisions to AT&T's underlying tariffs to take effect even after finding "serious flaws" in AT&T's cost support and recognizing the potential for price discrimination through cross-subsidization. Such was the case with Accunet tariff, which the FCC decided to let take effect rather than analyze the tariff for its possible impact on competition. Subsequently, OCC concerns were proven correct. The FCC declared the tariff unlawful.

(c) The FCC allowed AT&T's "Reach Out America" (Block of Time) pricing plan to take effect in spite of the recognition that the proposed rates were below the company's cost of providing the service. The FCC had disregarded the Department of Justice's expressed concerns about allowing AT&T a free hand in setting prices.

(d) In July 1984, the FCC reduced by half the length of public notice periods applicable to AT&T's tariff filings. This action has made public participation in the tariff filings. This action has made public participation in the tariff process very difficult, when coupled with the agency's decision allowing AT&T's tariffs to go into effect with minimal cost support material.

(e) AT&T's tariffs and pricing schemes should be cost justified, in light of its market power and incentive to exploit it. If this is not done, competition may not develop, and the AT&T divestiture will have served no purpose.

Would you please comment on each of these contentions?

Answer. (a) The Commission must continually balance the costs of regulatory restrictions against the public benefits which they produce. Before determining that ATTIS should be allowed to resell basic services offered by AT&T, the Commission undertook a reevaluation of the market to determine if the *Second Computer Inquiry* restrictions on such resale continued to further the public interest. The Commission identified three changes which had taken place in the market since the *Second Computer Inquiry*. First, the Commission had gained considerable experience regulating AT&T basic service offerings to ensure that it did not discriminate in favor of customers who used ATTIS CPE and enhanced services. Second, the number of companies providing basic services had increased, and many companies were reselling AT&T's basic services in the same way ATTIS would be able to under the Order. Third, ATTIS's market power in the CPE area had declined substantially.

Several public interest benefits were also identified as flowing from resale of basic services by ATTIS, including increased efficiency for customers and increased competition in a wide range of telecommunications services and products. As a result, the Commission concluded that the increasingly competitive marketplace for telecommunications services and equipment will serve as a constraint on anticompetitive behavior by AT&T. The Commission also found that the regulatory powers in Sections 201-205 of the Act, the complaint procedures in Section 208, and the reporting requirements we instituted would be adequate to protect against any potential harm resulting from resale of basic services by ATTIS. The Commission required that any AT&T basic services used by ATTIS be provided through nondiscriminatory tariffs and that ATTIS offer its basic services at just, reasonable, and nondiscriminatory rates and on an unbundled basis. Thus, ATTIS must take the underlying services under the same rates, terms and conditions as any other reseller.

(b) When the Commission is faced with tariff proposals that are not clearly lawful or unlawful, such as AT&T's changes to the Accunet tariff referred to in the question, it must determine the benefits to the public. As a rule, the public benefits from innovative and lower cost services. However, the Commission must guard against threats to competition or cross-subsidization from other service categories. In the case of Accunet, the Commission noted that, although the parties argued that there were "serious flaws" in AT&T's cost support materials, there were insufficient grounds to reject or suspend the tariff at that time. Therefore, the Commission determined that it was in the public interest to permit the tariff to become effective and to conduct an investigation into the tariff's lawfulness. The Commission's investigation of Accunet did demonstrate that AT&T's predictions were not borne out by experience. In those circumstances the Commission determined that the provisions must be rejected and took steps to assure that any revenue shortfall was not borne by ratepayers.

(c) In permitting the Reach Out America plan to take effect, the Commission noted that the proposed rates applicable to the night/weekend discount period did not recover access charges because access charges were not levied on a time-of-day basis. The Commission noted that even current long-standing night/weekend MTS and WATS rates are frequently priced below access costs. The discounted rates are permitted nonetheless because of their effect in improving efficient utilization of the network. The Commission found that the proposed rates approximated an average rate under AT&T's current night/weekend rate schedule. In addition, as in the case of Accunet, the Commission has expressed its willingness to require AT&T to terminate the offering if the eventual revenues do not reach the levels AT&T has projected. In fact, preliminary indications are that this plan is doing even better than projected.

(d) An Order we released on October 9, 1984, shortened the routine notice period from 90 to 45 days for dominant carriers' tariff filings that would increase or restructure rates, or introduce new offerings. The associated pleading cycle for petitions seeking rejection or suspension and investigation of these tariff filings was also shortened from 25 to 15 days. The Commission stated in the Order that the recodification and revision of Part 61 would enable it to meet statutory obligations while allowing subject carriers to operate more efficiently and to respond more effectively to competition. This action was designed to allow dominant carriers to compete more effectively with carriers now subject to reduced regulation as a result of the Commission's Competitive Carrier Rulemaking, wherein the Commission permitted non-dominant carriers to file tariffs on 14 days' notice and entirely relieved forborne carriers of tariff filing requirements.

The Commission balanced the benefits of a shortened notice period with the need to preserve its ability to perform its oversight responsibility under the Communications Act, which includes permitting meaningful public comment to facilitate review. We stated, however, that it has been our experience that most tariffs can be reviewed by the Commission and the public in a 45-day notice period. We also explained that for more controversial or complex tariffs, the Common Carrier Bureau would, in its discretion and under its delegated authority, extend the petition period, the notice period, or both. This has, in fact, frequently happened. It is more consistent with the objectives in our Order to retain the abbreviated pleading schedule for the majority of tariffs and to grant extensions of time to file comments on controversial or complex tariffs.

(e) The FCC recognizes that AT&T continues to possess market power. Thus, the Commission continues to treat AT&T as a dominant carrier. As such, AT&T is required to fully cost justify rate modifications. For instance, the Commission recently found unlawful AT&T's PRO American tariff offering on the ground that the cost data provided in support of the proposed offering failed to show that the service

would recover its costs over a reasonable period of time. The Commission is committed to fostering a fair competitive process. We recognize that until the market is sufficiently developed to constrain AT&T's market power, we must continue to scrutinize AT&T's offerings and activities.

Question. Critics of the FCC's current transition plan contend that it leaves new carriers no alternative but to adopt "temporary" and "costly" measures to compensate for the many advantages held by AT&T; and consequently they must spend a larger proportion of their revenues on advertising, construction, and operation, while simultaneously to charge rates significantly below those of AT&T.

Some of the problems they see are:

- The equal access process is very confusing to existing and potential OCC subscribers. AT&T's subscribers are unaffected by the conversions.
- Because of this piecemeal introduction of "equal access," the OCCs cannot effectively utilize the mass media for marketing or educational purposes. Such broadly distributed advertising would reach many users who could not yet make an "equal access" choice. This would be inefficient and confusing to the public.
- Other long distance companies must therefore solicit customers through means such as direct mail, telemarketing, or personal visits. These methods can cost 50 times more than mass media efforts, and have a much higher potential for failing to reach possible customers.
- Different areas of a single community will have different methods of access to the other long distance carriers. This will create considerable confusion for OCC subscribers when they travel. In some places "1+" dialing will be available for all carriers, and, in other locations, personal access codes will still be required.
- Subscription of AT&T imposes no confusion or inconvenience on consumers. The FCC should require the local telephone companies to end piecemeal conversion in favor of a metropolitan area basis, or require the competing carriers to pay access charges equal to AT&T's only after the entire area has been converted.
- In many instances, the Bell Operating Companies have introduced "equal access" long before installing tandem switches. These switches allow carriers to efficiently aggregate small amounts of long distance traffic.
- Without tandem switches, the new carriers face increased installation, testing, maintenance, and circuit administration costs. The number of private lines needed is substantially increased, and the inefficient network design which results causes higher costs and degraded access service. These facilities for which extra investment is required will have to be removed when the local telephone company later installs tandem switches.
- The FCC's findings that inferior interconnections place the other carriers at a serious competitive disadvantage requiring a significant difference in access rates is being undercut by state regulatory actions.
- While the FCC has concluded that the value of the inferior access is only 45 percent of that given to AT&T, many states are prescribing little or no difference in price for access for intrastate long distance services. Thus, the new carriers face costs nearly equal to AT&T, but can offer their customers only a lower quality service. This impedes the new carriers' ability to compete in the intrastate long distance market.

Would you please comment on each of these contentions?

Answer. These are issues raised in the OCC petition. The Commission is carefully evaluating each of the OCC's contentions and will address them in the context of that proceeding. Some general clarifications and observations, however, can be made at this time. With regard to marketing issues, as a result of the FCC's recent decision to require the BOCs to institute a ballot and allocation process, AT&T no longer merely inherits all defaulting customers after end offices are converted. Instead, AT&T, just like its competitors, must promote and advertise its services. This is because the FCC's recent decision requires that customers either affirmatively select the carrier of its choice or be defaulted to a carrier on fair allocative basis. Similarly, with regard to the question of "clustering" conversions of end offices, we are pleased to see increased voluntary action by many BOCs in this area. Pacific Bell, Bell Atlantic and Northwestern Bell have already announced "clustered" conversions of major metropolitan areas.

The Commission staff monitors tandem implementation directly through reports filed by the exchange carriers. We are looking into the allegations that both tandem switches and two-way trunks are scarce. With respect to allegations concerning state actions, it is important to point out that the FCC's decision has drawn criticism from all sides. While there is no reason to believe that 55 percent is a magic number, we do believe that it is fair to all concerned. Just as we have deliberated

long and hard on this and other issues, the states are actively grappling with issues related to the introduction of competition. It is important to recognize that a majority of states, approximately 31, have permitted intrastate competition for long distance service on either an interim or a permanent basis. Moreover, six states have already authorized intra-LATA competition. Thus, it is clear that competition is growing at the state level, and we believe it will continue to grow.

Senator GOLDWATER. Mr. Rule, you are the next witness. We are glad to have you with us. You are a very important part of this whole procedure, and you may proceed as you desire.

STATEMENT OF CHARLES F. RULE, DEPUTY ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Mr. RULE. Thank you, Mr. Chairman and members of the subcommittee. I do have a prepared statement, and I would be happy to very briefly summarize it. I know you all are on a very tight schedule, but I would be happy to answer any questions you may have, and I will also be happy to answer any questions that are submitted in writing, and if that is more helpful to the subcommittee, that is fine with me.

It is a pleasure to be here this afternoon to discuss two very important issues, the transition to equal access to local telephone networks for competitors in the long-distance service market, and the continued tariff regulation of AT&T.

As I said, I will briefly summarize my prepared remarks and I will then be happy to answer questions.

Over the last 15 years, the telecommunications industry, particularly the long-distance market, has been dramatically transformed. FCC deregulation of long distance and equipment provision has taken place. This has largely been driven by technology and other changes. Competition was coming, and a lot of the changes are just a reflection of that.

The Department of Justice, of course, has played a role. In 1974, an antitrust suit was filed against AT&T. It was designed to attack in effect AT&T's structure and conduct that it was believed inhibited technological progress to competition. In 1981 that case was—or 1982, that case was settled by a modified final judgment that modified the old *Western Electric* decree. That modification has two objectives, first to separate the regulated and unregulated aspects of AT&T to allow competition in the areas where competition was feasible while enabling regulators to continue to regulate those particularly local networks where, at least at the present time, technologically it is still a natural monopoly.

In addition, it was designed to remove restraints on AT&T's conduct that had been placed on AT&T in the previous decree.

The regulatory trend we believe has been beneficial and should continue. To us in the Department of Justice at the present time, the most important part of the modified final judgment is its equal access provisions. Those provisions are designed to allow all long-distance providers to have the same; that is, equal access of the same type, quality, and price to local telephone networks in order that long-distance companies may compete on an equal footing with AT&T. The process is moving along, as Chairman Fowler reported. We expect by the end of this year to have about 50 percent

of what are known as the local Bell operating company and offices cut over to equal access. There is a requirement in the decree that by September 1 of this year, which is this year, September 1, that one-third of the end offices be cut over, and that has been met.

Some local Bell operating companies have even gone almost as high as 50 percent. So it is moving along. By September 1, 1986, by and large, the process should be complete.

The Department currently is spending a great deal of its resources monitoring the progress of equal access. A few problems have arisen and we are currently investigating some of those, but we have a great deal of faith that the provisions of the decree will be met.

The other issue that I will just briefly touch on today, but that I have dealt with a little more in my prepared remarks, is the continued tariff regulation of AT&T. I want to just mention two things this afternoon. First, we in the Department believe that the deregulation of AT&T should proceed to the extent, and as quickly as, that is technologically and economically feasible and possible. The strength of this Nation is in large part due to its reliance on market forces, not Government fiat, to allocate goods and services. In long-distance service, which does not appear to us at this point to be a natural monopoly, the policy of unregulated competition, we believe, should prevail. The economy and consumers will benefit. Competition will provide new opportunities to some, and it will also result in the failure of others. That is the natural competitive process, and I do not believe that should deter us from following this policy of competition. Deregulation, however, should be stable and consistent. That has been pointed out a number of times this afternoon. I think that is very important in order to allow businesses and consumers to make decisions on a firm and stable economic planning basis.

Also, it is true that some regulation at the interface of long-distance and local-exchange access will continue. State and Federal regulators, we believe, should take care to craft regulations in this area in a way that minimizes distortion of market forces but takes care of the problems.

That concludes my summary this afternoon. I will be happy to answer any questions.

Senator GOLDWATER. Thank you very much.

Mr. Chairman, do you have any questions.

The CHAIRMAN. No questions.

Senator GOLDWATER. Senator Hollings.

Senator HOLLINGS. No questions, Mr. Chairman.

Senator GOLDWATER. Senator Inouye.

Senator INOUE. No questions, Mr. Chairman.

Senator GOLDWATER. Senator Ford.

Senator FORD. I can submit them in writing,¹ Mr. Chairman. I did not want to mess up the procedure.

Senator GOLDWATER. Well, thank you very much, Senator. That is very generous of you, and I will submit my questions, too.

[The statement follows:]

¹ See p. 263.

STATEMENT OF CHARLES F. RULE, DEPUTY ASSISTANT ATTORNEY GENERAL, ANTITRUST
DIVISION, DEPARTMENT OF JUSTICE

Mr. Chairman and Members of the Subcommittee: I am pleased to be here today to discuss two issues that have important implications for the United States' telecommunications industry—the transition to equal access, which is currently in mid-stream, and the appropriate level of tariff regulation of AT&T.

Over the last fifteen years, our national telecommunications policy has evolved from preservation of monopoly and extensive regulation to the promotion of competition wherever technologically feasible. The evolutionary deregulation of long-distance services has been manifested most recently by the AT&T divestitures and by Federal Communications Commission (FCC) rulings designed to speed the transition from regulated monopoly to full competition. The goal of public policymakers during this time of transition should be to ensure that competitive opportunity is maintained and enhanced. We should pursue means to eliminate unnecessary, burdensome and costly regulation in a manner that is clearly understood by both providers and purchasers of telecommunications products and services. This approach will lead to a more diverse marketplace and enhance the value of investments in new products and services. In particular, the policy should be one of deregulation of long-distance service as soon as that is economically and technologically feasible. Overall, this policy will lead to higher quality services to consumers at the lowest possible prices.

A. EQUAL ACCESS

As we assess the current state of affairs in long-distance telephone competition, it is important to keep in mind the basic purpose of our nation's equal access policy—to place all long-distance competitors on an equal footing in terms of their ability to obtain high-quality connection to the local exchanges. Prior to the breakup of the Bell System, AT&T had superior access to consumers seeking to use the telephone network, in both the ease of dialing and the quality of the transmission of the call. Prior to 1982, the American telephone system was engineered and constructed under the assumption that long-distance service would remain a monopoly. AT&T's long-distance competitors could not offer equal service to customers because the type of connection provided them was inferior to the provided AT&T. AT&T's superior access was based, of course, on its control of both the long-distance network and the local network. Because AT&T was a rate-regulated monopolist that also controlled the local network, those firms seeking to compete for long-distance service with AT&T faced a severe disadvantage that was unrelated to the quality of their own efforts. Very simply, the equal access process seeks to eliminate that disadvantage by requiring changes in local switches to provide long-distance carriers with access to end users that is equal in type and quality to that provided to AT&T.

The equal access policy is rooted in two sources. First, the consent decrees in the AT&T case and the GTE case require that the Bell Operating Companies (BOCs) and the General Telephone Operating Companies improve their telephone switching centers to permit customers to choose equal quality of interconnection to a number of long-distance carriers. Second, the FCC has ordered local operating companies to provide consumers with equal access to all long-distance carriers.

At present, the BOCs are between one-third and one-half of the way through the process of converting their office equipment to provide equal access to all competing long-distance companies; the GTE operating companies are just beginning this process. While the physical changeover of the switches has apparently proceeded rather well, there have been some problems associated with the process of implementing customer orders in an accurate manner.

We believe that two recent events should help resolve these problems. First, the FCC's institution of a ballot and allocation process has simplified the means by which consumers can choose a long-distance carrier. This process proved very successful when implemented by Northwest Bell earlier this year.¹ Second, at the Department's insistence, the BOCs have improved substantially the quality of information that they are providing long-distance companies in connection with the equal access requirements. The Department's position has been that consumers and long-distance carriers need accurate information from the local Bell companies to be sure that orders for service are being honored. We are concerned about the adequacy of the BOCs' efforts in this regard, and we are actively pursuing a comprehensive in-

¹ See Comments of the United States Department of Justice. In Re Access and Divestiture-Related Tariffs. CC Docket No. 83-1145 Phase I, filed April 8, 1985.

vestigation to ensure that this most important requirement of the decree is met. Most importantly, we believe that present problems can be corrected and that the process can be made to work.

The equal access issue is also relevant to the provision of information services, such as voice storage and retrieval and interactive data processing and transmission. Some of the BOCs have recently taken steps to open their switches to the providers of such services—in effect, to provide equal access to information providers. The Department hopes that such efforts to establish open architecture in their switches will encourage competition and efficiency in the provision of information services, and thus encourage firms fully to use rapidly expanding technological capabilities.

Finally, consumers in areas where equal access has been completed are receiving real benefits from significantly lower long-distance rates at no loss of convenience or voice quality. The ability of these consumers to have a meaningful choice of long-distance providers without sacrificing quality or convenience is the primary objective of the decree. The transformation of our vast telephone system to make it receptive to the full potential of new technology is plainly a large and complex process, but the potential price and service benefits to consumers make it well worth the effort. And we believe that those benefits will be attained.

B. TARIFF REGULATION

While the process for achieving equal access is complex, few, if any, industry participants currently challenge the wisdom of the underlying policy. Such consensus, however, does not exist with respect to the next issue I want to address—the appropriate manner and degree to which AT&T should be relieved of full tariff regulation on long-distance services. Rather, those involved—AT&T, its competitors, as well as regulators—have strongly held and diametrically opposed views with respect to this issue. In addition, the issues are so complex and technical that each side can cite facts and economic theory that seems to support its view of the world. With this caution, then, I will summarize the Department's general position on regulation, and then explain how we have applied that view in the telecommunications field.

As a general matter, the Department has been at the forefront of efforts to deregulate industries where competition is viable. In our view, this nations' economic strength is the result of our reliance on market forces, not government control, to allocate resources. Such reliance, which not only guarantees maximum prosperity but safeguards our political liberties as well, should be abandoned to the minimum extent possible and then only when government regulation is necessary to correct some manifest market failure. It is particularly important in the telecommunications industry—the nerve center of the information dissemination that is so crucial to the continued development of technology—that regulation not be allowed to blunt competitive forces and thereby diminish incentives for technological innovation.

It was a recognition of the need to eliminate unnecessary regulation that led to the AT&T divestitures. As long as AT&T controlled the local rate-regulated monopoly exchanges, it was deemed necessary to regulate heavily AT&T's long-distance services and even prohibit it from engaging in new technologies, for fear that AT&T would use its local power to distort competition in the other markets. That regulation undoubtedly raised the costs of AT&T's competitors and the price consumers paid for long-distance service. The purpose of the consent decree was to restructure the Bell System to separate AT&T's competitive activities from its local regulated monopoly activities. This restructuring, it was believed, ultimately would permit the deregulation of AT&T. Accordingly, the question is not whether AT&T should be deregulated, but when complete deregulation should take place. While there are a number of tariff issues that affect deregulation, I would like to touch briefly on two: increased pricing flexibility for AT&T and access charges.¹

During the transition to equal access, two factors must be balanced in evaluating whether AT&T should be given more flexibility to make pricing decisions based on its own business judgment rather than on regulatory constraints. First, we believe that allowing firms to market their services based on their own business judgment

¹ See, Comments and Reply Comments of the United States Department of Justice, "In Re Guidelines For Dominant Carriers' MTS Rates Structures", CC Docket 84-1235, 50 Fed. Reg. 1881 (Jan. 14, 1985); Comments of the United States Department of Justice, "In Re Furnishing of Customer Premises Equipment and Enhanced Services by American Telephone and Telegraph Co.", CC Docket No. 85-26, 50 Fed. Reg. 9060 (March 6, 1985); Comments and Reply Comments of the United States, "In Re Long Run Regulation of AT&T's Basic Domestic Interstate Services," CC Docket No. 83-1147, Notice of Inquiry, 95 F.C.C. 2d 510 (1983).

will generally improve competition and efficiency to the benefit of consumers. The Department believes that price reductions and new services are generally beneficial to consumers and should not be discouraged by burdensome regulation. Moreover, even during this period of transition from regulation to competition, we believe it is appropriate to minimize regulation of rates and facilities to the extent possible in order to promote competition and efficiency. Thus, the Department has supported the FCC's effort to change current regulations to provide AT&T with pricing flexibility. Those changes would move from requiring AT&T to establish the reasonableness of its rates on a fully-allocated cost basis to a less cumbersome standard—net contribution to revenues. That flexibility, with appropriate safeguards, will allow AT&T to respond to market forces and enhance competition in the telecommunications industry, even though it may result in the exit of some less efficient and innovative firms from the long-distance market.

At the same time, the Department recognizes that in the short run—that is, until the transition to equal access is largely completed and while AT&T is subject to overall rate of return regulation—some minimal regulation is necessary to ensure that AT&T does not engage in truly predatory pricing that would threaten long-term competition in the industry. We believe that the “net contribution to revenue” standard, if strictly enforced by the FCC, will permit sufficient scrutiny to detect such anticompetitive pricing and still allow procompetitive pricing flexibility that will benefit consumers.

Any changes in the current regulatory structure are complicated, however, by the current access charge system that has resulted in problems in the efficient use of the long-distance network. Under the present access charge system, the fixed costs for long-distance service, which must be recovered regardless of the volume of traffic, are recovered primarily from long-distance carriers through access charges that are based on the long-distance traffic generated by a carrier's customers. Such a system of fixed-cost recovery based on usage creates problems that distort the allocation of society's resources; for example, the current system encourages uneconomic bypass. We believe that these problems deserve attention.

While we continue to believe that changes in the tariff regulation of AT&T are appropriate, it is also important that changes be implemented in a deliberate, predictable and stable manner. No one should expect perfectly accurate foresight in an industry rapidly changing due to new technology. On the other hand, sporadic or sudden shifts in public policy or regulation will only serve to exacerbate current problems. Both new investment and consumer satisfaction will best be promoted by an enlightened and consistent policy of moving toward full and unfettered competition.

In closing, let me reiterate that the provision of equal access to long-distance companies, and the evolution to a telecommunications industry that is open to all information service providers, will lead to a healthy competitive environment affording the highest quality services at the lowest possible costs to consumers. As we approach the full implementation of equal access, we should continue to seek to minimize regulatory constraints and allow free market forces to work.

Mr. Chairman, that concludes my prepared remarks. I would be happy to respond to any questions that you or other members of the Subcommittee may have.

Senator GOLDWATER. The following witnesses will please come up: Mr. Charles Brown, chairman of the board, AT&T; William McGowan, chairman of MCI Telecommunications; Ted Brophy, chairman and chief executive officer of GTE.

I would like to make one short statement before we start. Because of my lifetime interest in communications, I wanted to note the announcement last week that the AT&T and the Bell Laboratories, which invented the transistor, were also the first in the world to begin production of the one megabit computer chip. This chip is four times as powerful as any existing memory chip and will help lower costs in long distance and other areas.

It is nice to have some good news for a change. I know we are in a race with the Japanese on this next generation of chips, and I for one am glad to hear that American technology came in first.

You may proceed.

I have Charles Brown down as No. 1, so proceed.

STATEMENTS OF CHARLES L. BROWN, CHAIRMAN OF THE BOARD, AMERICAN TELEPHONE & TELEGRAPH; WILLIAM G. MCGOWAN, CHAIRMAN, MCI TELECOMMUNICATIONS; AND THEODORE F. BROPHY, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, GTE CORP.

Mr. BROWN. Mr. Chairman, I thank you very much for your comments on the megabit chip. The Bell Laboratories is alive and well.

It seems to me that the true test of competition in any industry lies in how well the public is being served and how free suppliers are to produce.

In the long-distance market, customers are clearly getting choices. There are a vast number of suppliers contending for their business, and we have seen some reduction in prices. The public has also seen new offerings, most notably in the introduction of calling plans. But I believe most people would agree that the American people have not yet seen the full benefits of competition which they were led to expect as a result of the breakup of the Bell System.

The public deserves far more innovation and much sharper price reductions. Breaking up the Bell System entailed considerable cost, confusion, and disruption; for customers, for employees, and for some 3 million shareowners of AT&T. The high cost of divestiture, however, was supposed to be worth its promise—the promise of competition—and the benefits it would bring to the public.

But that promise has been retarded by continued complaints by competitors and by regulatory involvement in the marketplace. While the FCC has made progress in freeing the marketplace for competition, AT&T still operates under a number of handicaps and the same regulation which applied when it was monopoly and which now deny its customers rapid delivery of new services and price reductions. At the other extreme, AT&T's competitors continue to receive special advantages, and they operate nearly free of regulation.

The time is coming when the large advantages that our competitors have enjoyed is scheduled to be largely phased out. I am speaking of the deep discounts, some 55 percent, that our competitors have received for years on charges paid to the local telephone companies for completing long-distance calls over their facilities. As competitors are provided connections equal to AT&T's, this discount is scheduled to disappear. The discount has enabled other long-distance companies consistently to set their prices just below AT&T's tightly regulated prices.

The overall effect, of course, has been to keep long-distance rates higher than they need to be. In their efforts to maintain the discounts, competitors are making exaggerated complaints about the local operating companies' provision of equal access. By and large, however, the inherently complex transition to equal access has proceeded in an orderly way.

At the same time, other regulatory restraints on AT&T are under discussion at the FCC. Unlike our competitors, we must negotiate the regulatory labyrinth each time we wish to change prices or offer a new service. This has delayed competitive initiatives and provided our rivals the opportunity to prevent lower

prices to customers by means of endless lawyering in the regulatory arena. Most of the States, as a matter of fact, are ahead of the FCC in providing more flexible and equal competition for all long-distance carriers, including AT&T.

The prospect now of a fairer marketplace, where the rules are more or less the same for all, has prompted a number of competitors to seek to prolong the discounts and oppose any additional freedom for AT&T. In short, they want continued shelter and protection, and I do not believe the facts warrant that or that the public would be well served. Competitors in the long-distance market today are large, financially strong, and growing. They are investing billions of dollars to expand and enhance their networks and to get into other businesses. They have millions of customers in the most profitable markets they have elected to serve, and their own assessment of their prospects when they speak to their share owners and to the financial community glow with optimism.

But of course, this is less true when they speak within the beltway.

AT&T competitors now serve 5 million customers. They gather more than \$5 billion a year in interstate long-distance revenue alone. In the lucrative, low-cost, high-profit segments of the market that they have targeted, competitors have important market presence. They serve nearly half the targeted business customers they want to serve, that is, those who spend more than \$50 a month on long-distance service, and they serve one in five targeted residence customers who spend more than \$25 a month for interstate calls. These are markets where competitors are most active and where competition for customers is most heated.

That raises another matter for consideration. AT&T's market share of toll revenues is now about 63 or 64 percent according to the Department of Commerce. However, AT&T has 100 percent of the market which nobody else wants to serve, the market which includes small towns, low volume rural areas, and customers who make very few long-distance calls but who very obviously depend on AT&T for the few calls they do make. AT&T can and will continue to serve these customers if given a reasonable opportunity to compete for the profitable long-distance markets which can offset the others.

However, if these mindless subsidies and discounts to competitors are continued, there is considerable doubt that AT&T's rate averaging which permits low-cost long-distance service can really continue.

The general thrust of the FCC's direction has been encouraging. It is moving, though painfully slowly, toward full and fair competition. The goals that are now set for the industry should not be undermined.

In experiencing the divestiture trauma, the American public has already paid a very steep price for the introduction of competition. I think it is fair to say that the general attitude is one of unhappiness and confusion. Now it is time at last—or at least—to deliver on the promises of a truly competitive era. It is time to let technology loose to produce attractive, low-priced services, time to free every company to deliver those services as swiftly and as efficiently as possible, time to let true costs determine the service prices.

In view of the discussion earlier this afternoon about deregulation of AT&T, I would like to point out that AT&T has not been deregulated at all, aside from a shortening of from a 90-day period to a 45-day period of the time in which the FCC may look at its tariffs without suspending them. That is the only deregulation I know about, and that hardly should be described as deregulation.

AT&T is still laboring under the full regulatory panoply which it has ever since it was a monopoly. It is my hope that the committee will lend its encouragement and its support to the efforts that will bring about a fully and truly competitive marketplace.

Thank you, Senator.

[The statement follows:]

STATEMENT OF CHARLES L. BROWN ON BEHALF OF THE AMERICAN TELEPHONE & TELEGRAPH CO.

This statement responds to your request for AT&T's perspective on competition in the long distance business, particularly in view of events since divestiture. To summarize, it is our view that competition is intense and will (with fair and realistic regulatory policies) continue to thrive; that some progress has been made in removing the needless regulatory obstacles that bind AT&T alone among all long-distance carriers; that this progress is far too slow because no reason exists for failing to remove these restraints on AT&T now; that AT&T continues to carry the burden of serving customers and areas as a "carrier of last resort" rendering long distance service to people who only occasionally call long distance and who are unwanted by the OCC's; that the demands by some of AT&T's competitors for more burdens on AT&T and more subsidies for themselves are unfair and unjustified; and that for as long as AT&T is prevented from taking its place as a full competitor in this industry, American consumers will be deprived of the full benefits that AT&T's technology and innovations could bring to them.

Divestiture is now twenty months in the past. On January 1, 1984, AT&T spun off the local Bell operating companies. The divestiture was required by a consent decree that ended more than three decades of antitrust litigation by the Department of Justice and endless debate in the agencies and legislatures over what constraining rules were desired to ensure that the Bell System did not leverage its "bottleneck" local facilities in favor of its long-distance and equipment businesses. AT&T agreed to the consent decree because it had become clear that the controversy that engulfed the industry was inherent in the structure of the Bell System. Even if AT&T won the litigation with the Department of Justice, disputes over AT&T's structure would have continued as long as competitive operations remained combined with what the Justice Department considered to be local exchange monopolies. That controversy would have continued a cloud of uncertainty over the entire industry, discouraging capital investment and dampening innovation, to the detriment of consumers and all the industry's participants. Despite the undisputed exemplary performance of the Bell System in the interest of this country, the clamor for change continued.

Divestiture was to end that controversy and uncertainty. Dividing the Bell System between the competitive operations (which AT&T retained) and the local exchanges (which were divested) put to rest allegations that AT&T could misuse its control over the local exchange "bottleneck" to restrain competition in the long-distance and telephone equipment markets. The decree also required that the Bell operating companies continue the program to provide AT&T's long-distance competitors equal access to the local networks, for which they were to pay equal charges. These provisions, along with the complementary policies of the FCC, would encourage vigorous competition—which was already booming, in both the long-distance and telephone equipment markets.

Recognizing that divestiture left AT&T as a competitor, not a monopolist, the consent decree also removed the restrictions from an earlier decree that had confined AT&T by-and-large to providing regulated communications services. And by requiring AT&T's divestiture of the Bell System's local facilities, the decree further set the stage for agencies like the FCC to remove all the other regulatory barriers that had been imposed on AT&T because it owned the local exchange "bottleneck." AT&T, in short, was to be free to compete in all markets to which its dynamic technology would lead. Through such competition, consumers would obtain the benefits

of innovative service offerings and lower prices and the United States would enhance its international leadership in information technology.

These massive changes in the industry's structure have come only at a high cost. The divestiture itself was the largest and most complicated business reorganization in history. Telephone customers have been perplexed and frustrated as a result of the abrupt changes in our industry. AT&T and Bell operating company employees have paid an especially high price, and for many of them the upheaval is not yet over. The far-reaching changes with divestiture and force adjustments demanded by the marketplace have eliminated many jobs, shifted thousands of others and caused understandable concern for all of our employees.

Were these costs worth it? Their justification was supposed to be that all firms in the newly-structured industry—including AT&T—would be permitted to compete free of out-dated and unnecessary regulation, and on the basis of their true costs, bringing to consumers the benefits of lower prices and innovative services. I have to tell you, however, that progress toward these goals has been too slow and needlessly delayed, and that consumers have yet to receive the benefits they were promised and legitimately expect. Obsolete regulatory practices have perpetuated subsidies to AT&T's competitors and their customers that are fundamentally inconsistent with competition. Regulatory burdens imposed in 1980 on AT&T, designed for a pre-divestiture world, prevent AT&T from offering customers the lower prices and creative services that its people and its technology could bring.

The FCC has begun to make progress toward reducing these obstacles to competition which hurt consumers. The Commission has, for example, reduced somewhat the length of regulatory review before AT&T's new service offerings can be brought to the market. It has also adopted a program to reduce unfair and inefficient subsidies in the pricing of access services, which have artificially inflated the cost of long-distance calling. This program gradually will align prices more closely with costs, lead to greater efficiency and lower prices, and reduce incentives for by-pass of the local telephone companies.

Instances of such progress have been far too few, however, and too long in coming. It has been 20 months since divestiture occurred and three and a half years since AT&T agreed to it. There is little reason to have kept the restrictions on AT&T's ability to compete long after their original basis ended. There is every reason to remove them. The FCC has ample authority from the Congress to take the needed action and is apparently in the process of doing so.

The FCC can and should eliminate the onerous tariff regulations that now apply to AT&T but not to its long distance competitors. These costly and protracted regulatory procedures are not only unnecessary but are used by AT&T's competitors to block innovative services and price reductions that would benefit consumers. As just one example, AT&T's "Pro-America" optional calling plan, with attractive rates for small business customers, was filed in February of this year and has been suspended since May—with the only requests for suspension or rejection coming from AT&T's competitors. Eliminating these burdensome requirements, designed for a monopoly age that has passed, will speed innovation, reduce costs, and lower prices.

These innovative rate plans are wanted and needed by customers as is illustrated by AT&T's "Reach Out America" plan which, after months of delay by competitors' complaints to the FCC, finally went into effect and has attracted 1.7 million customers in a period of 13 months.

There is ample precedent for streamlining and equalizing regulatory impediments to rate competition. Almost two-thirds of the states have already acted to endorse competition in the telecommunications market, and have taken a leadership role in deregulating the industry—including AT&T. Twenty-two states have acted through their public utility commissions, while fourteen have taken such action through their legislatures. States which have adopted statutory or regulatory flexibility and non-discriminatory treatment of AT&T include Missouri, South Carolina, Arizona, Oregon, Virginia, Kansas, Washington, Nebraska, Tennessee, and Louisiana. The degree of streamlining varies from almost complete flexibility in Virginia and Nevada to removal of tariff hearing requirements within broad ranges of rates in thirteen states including Missouri, South Carolina, Kansas, Nebraska, and Oregon.

This leadership role by the states has included reduced OCC discounts on access, removal of rate of return regulation, and approval of innovative services and pricing options, such as "Reach Out America" and "Pro America." "Reach Out America"-type options have already been approved in over eighty percent of the states where filed and similarly "Pro America"-type plans are already effective in seventy-five percent of the states.

The FCC's "structural separation" rules should also end. They too were based on AT&T's former ownership of the local exchange companies. They needlessly add

hundreds of millions of dollars to AT&T's costs (and customers' prices) by irrationally requiring AT&T to operate as if it were two different companies. These rules hurt AT&T's competitiveness overseas, and result in lost American jobs, both union and management. These now-purposeless rules are not applied to a major competitor, IBM, which has billions more in assets, dominates the world in computers, and itself owns both an equipment manufacturer (Rolm) and part of a long-distance company (MCI-SBS); nor to GTE, which not only both manufactures equipment and owns a long-distance company (Sprint), but even controls a large local exchange monopoly.

Not surprisingly, these continued requirements are opposed by telephone customers (whom they hurt), and are favored only by AT&T's domestic and foreign competitors (who want AT&T handicapped). These rules should be abolished so that AT&T, like any other company, can bring our unified technology, services, and products to customers efficiently, and at the best price.

The plain fact is that AT&T's competitors do not want AT&T freely to compete with them. Rather, they want more handicaps put on AT&T, and more subsidies for themselves. In short, they want protection from competition. The competitors wrap their self-serving agendas in a threat: that if AT&T is permitted to compete like every other firm, competition itself will not survive. Four of AT&T's competitors recently presented just such an agenda in a highly publicized filing with the FCC.

In the name, they say, of "competition," these competitors asked that they continue to receive the enormous discount on the price they pay for access, even after their access is equal. They want a "moratorium" on price competition by AT&T, while they would be left free to price as they wished. And they want to be given a variety of AT&T's proprietary assets, instead of incurring the normal competitive expense of developing their own. These protectionist requests have been considered and rejected in the past, would hurt, not help, consumers, and are wholly inconsistent with genuine competition.

AT&T's competitors have long contended that to compete with AT&T, they need equal access to local exchange facilities. And they said that when they got it, they would pay the same price. In response to their demands, they have been given precisely what they sought: a program to phase-in equal access at local telephone offices nationwide and quickly. This is the measure of equal access the competitors said they wanted. It was adopted by the Department of Justice and the District Court in the AT&T Consent Decree. This measure of equal access was adopted and ordered by the FCC, which also ordered that the competitors pay equal charges for it. Indeed, the concept that the OCC's should pay full access costs for equal access was adopted by the House of Representatives in H.R. 5158 several years ago and by the Senate in S. 898. But now that they are getting equal access, they don't want to pay for it. They say that business problems they are having justify a continuation of their massive discount even where they receive equal access. They also complain about the implementation of equal access by the operating companies. These complaints against the operating companies are greatly exaggerated. By and large, the inherently complex transition to equal access has proceeded in an orderly manner.

The FCC has already properly rejected the competitors' demand that they continue to get a discount where their access is equal. The Commission intended specifically that the enormous 55 percent discount, which the FCC itself had ordered at every office where equal access is not available, *more* than compensates competing carriers for all the alleged "disadvantages" associated with the transition to equal access, and that the discount be phased out as equal access was phased in office-by-office. The size of the discount and its scheduled phase-out are so inextricably tied that the Commission concluded that any modifications in the phase-out as proposed by competitors would require that the present 55 percent discount be reduced.

Indeed, because the discount more than compensates these carriers for any transitional difficulties (the Commission has acknowledged that the discount may be "excessive"), the carriers have enjoyed for several years an overwhelming advantage because of the discount. They pay so much less for discounted access than AT&T pays that they can take the benefits of these lower costs and, in turn, offer prices lower than AT&T's, even in areas where they do receive equal access. For example, when equal access is available for half of the nation's telephones, the average discount will still be excessive by any standard—27.5 percent. They can use this discount nationwide to price below AT&T's rates. There is no reason whatever to perpetuate this subsidy by continuing the carriers' discount even longer. They cannot have it both ways: Where they get the same access they must pay the same price or the principle of competition is turned on its head.

The plea from AT&T's competitors for a "moratorium" on price competition by AT&T also has no merit. Preventing competition by one firm defeats the purpose of a competitive marketplace. These competitors simply want AT&T stopped from of-

fering creative and efficient calling plans—like “Reach-Out America”—which attract and benefit customers, stimulate efficient use of the network, and are profitable. Their claims that “Reach Out America” was below-cost or otherwise improper have been fully considered and rejected by the FCC.

Our competitors' additional request for a free ride on AT&T's proprietary customer data and business systems used to provide “800” service would not only be an unlawful taking of AT&T's property, but would run completely counter to the policy of promoting competition. AT&T's right to the exclusive use of these assets assigned to it by the consent decree was established unequivocally by orders of the District Court. And as the court recognized, competition means competitors should develop their own technology, not have somebody else's handed to them.

In complaining that unless they are subsidized and AT&T handicapped, competition will not survive, competitors rely on a forecast by the Booz, Allen & Hamilton consulting firm that the four companies studied may be only marginally profitable for the next few years. Yet, the Booz Allen firm itself disavowed their clients' conclusion that the study showed competition was in jeopardy. Even MCI disassociated itself evidently from the study.

If anything, the study shows just what one would expect from competition: that new firms acquiring massive revenue gains have to forego some short-term profits if they want to acquire market share through aggressive pricing and substantial investment in their networks. That is, in fact, what these firms are doing. Some of the evidence of their dramatic success and the vigor of their competition is set forth as an Appendix to this Statement. As the evidence confirms, they already have invested substantially in their networks and with that investment they compete vigorously in all financially attractive parts of the market. In addition they have acquired funds to get into a number of other markets such as paging, cellular radio, electronic mail, etc. Eighty percent of all telephone customers are now offered service by two or more long-distance carriers. Competitors today serve five million customers and reap more than five billion dollars a year in interstate long distance revenues. In the lucrative, low-cost, high profit segments of the market they want to capture, competitors have substantial market presence. AT&T's competitors have signed up nearly half of the targeted business customers who spend more than \$50 a month on long distance service. (This customer group accounts for 90 percent of interstate long distance business revenues.) In the residential market, competitors serve one in five targeted customers who spend more than \$25 a month for interstate calls, and one in three of those who spend \$100 or more a month.

The market success of AT&T's competitors has led to still greater investment (e.g., GTE's acquisition of Sprint at twice book value) and plans for still more investment in the future (e.g., IBM's commitment to invest \$400 million or more in MCI, and GTE's and MCI's plans to invest more than \$1 billion each in their networks in 1985 alone). These investments are being made, moreover, with full knowledge that these firms would have to compete on the merits, including paying equal charges for equal access.

AT&T's competitors' own business decisions and their success in the marketplace thus refute their dire predictions that competition will not survive unless AT&T is hamstrung. Indeed, these companies admit as much when speaking to the capital markets from which they attract investment, rather than to the regulatory agencies from which they seek subsidies. GTE Sprint's president, James Broadhead, told securities analysts just last month that Sprint “should be close to breaking even in 1987 and certainly should be profitable by 1988”. He said that this projection assumes that federal officials will not make any major changes in long-distance regulation—that is, will not change the requirement that competitors pay equal prices where access is equal. U.S. Telecom's president, Charles Skibo, has recently reiterated that his company is committed to “a major expansion” through the building of a national fiber optic network which he believes will make U.S. Telecom one of the lowest cost long distance carriers in the business. In reporting a revenue rise of 58% for the first six months of 1985, he also indicated an intention to expand the range of services offered in such areas as videoconferencing, virtual private networks, credit cards, 800 services and international marketing. These positive sentiments were echoed by United Telecommunications' chiefs executive officer, William T. Esrey, who told the New York Society of Security Analysis that his company has a “strong capital structure.” He stated that U.S. Telecom's 1985 \$596 million construction budget and the 1985 \$580 million construction budget of United Telephone would be generated entirely internally, and he expected to improve the dividend payout ratio through “strengthening earnings.”

Under normal circumstances in an industry that provides this kind of opportunity, productivity will increase, services will proliferate, and prices will fall. But in

order to bring down prices, AT&T must have the competitive earnings opportunities and pricing flexibility that all of the other long distance carriers already have. The efficiently managed carriers will do well. The critical point is that streamlined and equal price and earnings regulation is essential to consumers' welfare and genuine competition.

There is another matter to be considered here. AT&T's market share is now at about 63% according to Department of Commerce figures. However AT&T has about 100% of the market which its competitors do not want, that is the service from small towns and rural areas and from customers who make few long distance calls. AT&T can and will continue to serve these areas and customers if given a reasonable opportunity to compete for the profitable parts of long distance service. However, if the contrived interference with the market is continued by a mindless extension of subsidies and discounts to competitors, there is little hope that AT&T can offset the burden of low volume users and provide low cost long distance service to everyone who wants it.

Twenty months have passed since divestiture. The actions needed to bring consumers the benefits they expected from the massive reorganization of the telephone business are clear. The regulatory restrictions which inhibit AT&T from bringing creative and competitively-priced services to the market swiftly, and from organizing itself rationally to provide customers these services, must be eliminated. These restraints were designed for a different era, and now hurt rather than help consumers. Having come this far down the road with competition, and having endured the turmoil, there really is no other choice: the only way to ensure that real competition starts and that consumers benefit from it is to let the competitors compete—introducing services and changing prices as quickly as market opportunities present themselves, and earning at margins that allow well managed carriers to stay fit and healthy for repeated encounters in the marketplace.

The FCC has been given ample authority by the Congress to take the necessary actions, has begun them in some areas, and is in the process of addressing others. There is no reason not to complete the job expeditiously, and no reason to believe that the FCC will not do so.

APPENDIX—TELECOMMUNICATIONS: A RIVALROUS MARKETPLACE

Introduction

The interexchange telecommunications marketplace has undergone dramatic change since public policy began to encourage competition. There can be no doubt that, today, long distance exhibits all of the attributes typically associated with a rivalrous marketplace. Over-simplistic measures of competition such as market share are highly misleading. The appropriate measures of a competitive marketplace are the growth of competitors's subscribers, assets, and revenues; growth in the quantity of competing providers supplying a growing number of services; absence of barriers to entry; competitors' successes in targeted markets; marketplace perceptions; and relative network capacity. By all of these standards, the interexchange market has evolved into a fully competitive marketplace. Furthermore, the market is rapidly transforming into a global information market in which large, multinational companies—not only those providing long-distance transmission—are deeply engaged.

Statement of Position

The data contained in this Appendix highlight the characteristics of the marketplace and include specific facts to support the conclusions. The following are the major points presented:

1. AT&T competitors have achieved high levels of success and are growing and maturing at a rapid pace.
2. The equal access structure has been implemented to enhance development of competition.
3. Growth of long distance transmission capacity is explosive.
4. Competition in the interexchange marketplace is appearing from a growing array of diverse, often unexpected suppliers offering a widening range of services in response to market opportunities.
5. The pace of mergers, acquisitions, re-positioning, and churn among suppliers has quickened in response to the increase in competitive activities and the need to keep pace with marketplace developments.
6. AT&T has no significant market power in this market.
7. Because of the changing industry structure, the issue of whether long distance telecommunications is a natural monopoly has become moot.

8. Competition in telecommunications is not limited to domestic markets but has expanded into international arenas as well.

9. Telecommunications is rapidly evolving from a distinct industry into a key, indistinguishable component of the Information Movement and Management (IM&M) market.

AT&T competitors have achieved high levels of success and are growing and maturing at a rapid pace.

The growth rates of these competitors are readily apparent from the successes they have enjoyed.

Fact: Over 5,000,000 customers currently subscribe to carriers other than AT&T.

Fact: Roughly half of targeted business customers and one in five of targeted residence customers subscribe to OCCs.

Fact: AT&T's competitors have increased their customer base by over 60% since divestiture. Both GTE Sprint's and MCI's customer base have tripled since year-end 1982.

Fact: MCI's revenues have climbed from under \$100 million in 1978 to close to \$2 billion in 1984. Similarly, GTE Sprint's revenues have grown from under \$50 million to over \$1 billion in the same time frame.

Fact: Allnet, a reseller, had revenues of \$1.8 million in 1981 and revenues of \$287 million just three years later.

OCCs now provide service in areas covering a high percentage of the country's population.

Fact: MCI services over 450 metropolitan areas, and its network reaches 80% of the United States. It plans to operate in every U.S. LATA by March of 1986.

Fact: 32 states have at least one OCC certified to provide intrastate long distance services. These states represent over 88% of intrastate toll revenues generated by AT&T.

Carriers are expanding their array of service offerings.

Fact: OCCs are continuously adding improved public switched network services, such as WATS-like offerings, directory assistance, travel services, and credit card calling.

Fact: In 1983, only one OCC provided international services. Through the first half of 1985, OCCs now provide service to 33 countries. MCI claims it provides services or has agreements with countries that represent more than 50% of the world's telephones and plans to serve more than 80% of the international market by year-end 1985.

Fact: OCCs have begun providing enhanced services as well. MCI offers digital data services, Datanet Packet Switching Service, and MCI Mail. Three companies, MCI, ISACOMM and Western Union, announced virtual private network services in May, 1985. Also, the acquisition of SBS gives MCI additional offerings such as high speed switched data service and a virtual private line satellite service.

Interexchange competitors are not merely "ma and pa" operations but include, or are part of, some of the largest corporations in America with strong histories in competitive arenas.

Fact: ITT, parent of USTS, had assets in 1984 in excess of \$30 billion. IBM's assets were \$42.8 billion. GTE's were \$26.4 billion. RCA, parent of RCA American and RCA Globecom, has assets exceeding \$8 billion.

Fact: At the end of 1984, MCI had \$3.89 billion in assets, including \$865 million in cash. GTE Sprint's assets have gone over the \$1 billion mark, compared to the \$150 million in assets it had in 1978.

The magnitude and growth of advertising expenditures by competitors also indicate high levels of marketplace activities.

Fact: Roughly \$70 million were spent on advertising long distance services by AT&T's competitors in 1984.

Despite statements to the contrary in regulatory and legislative forums, the OCCs themselves have repeatedly issued bullish statements regarding their ability to compete successfully in the marketplace. Industry analysts share that optimism.

Fact: In January, 1985, V. Orville Wright, President of MCI, told a Financial Analysts Federation conference, "I predict that MCI will end 1986 with 10-15% of the nation's long distance customers. I hardly need to emphasize our pleasure at that rate of success."

Fact: On July 15, 1985, Bear, Stearns & Co. issued a "Continuing Buy" recommendation on MCI, viewing MCI shares as being undervalued. The report notes, "MCI's motives [in entering into its association with IBM] were to secure access to Fortune 500 accounts which SBS's customer roster and IBM's marketing prowess assure; gain additional financial resources; and insure its position as the second largest long-distance company. These objectives seemingly have been met."

The equal access structure has been implemented to enhance development of competition.

The fundamental purpose of equal access is to—once and for all—quiet the allegations that one carrier has any advantage over any others.

Fact: In an Opinion dated August 11, 1982, Judge Greene stated, "This broad guarantee of equal treatment, when implemented, will effectively remove any inter-connection-type obstacles to free competition between AT&T and the other carriers

Through the equal access cutover process, customers across the country are being given competitive choices.

Fact: Almost 15 million residence customers and 2.5 million business customers have been cutover through 2nd quarter, 1985. These numbers will rise to 29 million and 4.6 million, respectively, by the end of 1985.

The OCCs themselves have recognized the value of equal access to their competitive efforts.

Fact: In January, 1984, Mr. Wright told the N.Y. Society of Security Analysts, "Now, for the first time, we [MCI] will have the opportunity to provide service on an equal basis, so we anticipate we will be able to compete and to accelerate our growth."

Fact: In his Report to Stockholders at the 1984 Annual Meeting, Mr. McGowan stated, "To MCI, equal access represents an enormous opportunity . . . We face a future as bright as any in American business."

Growth of long distance transmission capacity is explosive.

OCC construction budgets are in the billions of dollars per year, substantially exceeding AT&T's spending for new capacity.

Fact: MCI and GTE Sprint had 1984 construction budgets of nearly \$1 billion, each roughly equal to AT&T-C's 1984 budget of \$1.1 billion for new additions.

Fact: MCI plans to add 130 million circuit miles in 1985 producing a total of 340 million circuit miles at year end. GTE Sprint plans to add 100 million circuit miles in 1985 using satellite facilities.

Fact: MCI is tying its network together with state-of-the-art software driven digital switches, giving its engineers the flexibility to enrich and enhance its fiber optic capabilities.

Other vendors are entering the market to provide bulk capacity to carriers, further reducing entry and exit barriers.

Fact: Joint ventures are being entered into to develop fiber optic networks with railroads as a critical partner. AMTRAK, CSX, Florida East Coast Railway C., and the Missouri-Kansas-Texas Railroads have announced such partnerships.

Fact: Ten fiber optic cable providers have plans to spend roughly \$3.6 billion by the end of the decade to create almost 3.1 billion circuit miles of new capacity.

Both existing and new satellite carriers are petitioning the FCC for transponders and/or adding to in-place capacity.

Fact: By year-end 1984, AT&T-C had 20% of the transponder capacity, down from the 24% it held in 1982. It is projected that by 1987, AT&T will have less than 9% of the capacity.

Fact: In July, the FCC approved eleven applications for new satellite launches. Seven of the applications were for additions to existing systems while four firms—Ford Aerospace, Martin Marietta, Comsat General and Federal Express—were authorized to operate new systems.

Fact: Niche suppliers such as Equatorial, Private Satellite Network (PSN) and Argo are leading or buying transponders and using the capacity to provide specific applications such as one-to-many data services.

Competition in the interexchange marketplace is appearing from a growing array of diverse, often unexpected suppliers offering a widening range of services in response to market opportunities.

Television and radio networks are combining telecommunications with their video and voice broadcasting.

Fact: Metromedia Broadcasting has applied for paging, DTS, and other authorizations. They have the largest radio paging business and are a leading player in the cellular mobile phone market.

Fact: The National Association of Broadcasters is urging member radio stations to utilize excess signal capacity (FM subcarrier frequencies) to provide customers with low cost private communications, such as electronic mail and paging. Mutual Broadcasting is advertising a wide range of FM subcarrier services.

Owners of private information transmission networks from non-telecommunications industries are marketing their excess capacity.

Fact: Companies such as Sears, Merrill Lynch, and American Express are making use of their sophisticated billing systems and/or large credit card customers to market communications services.

Fact: South Carolina Electric and Gas Corporation is building a fiber optic network for its own use, and has announced it will market excess capacity.

Real estate developers are entering the marketplace by building telecommunications capabilities into offices and industrial parks.

Fact: There are now over 270 teleport and Telecommunications Enhanced Real Estate projects in operations or in progress. In 1981, there were none.

Fact: United Telecom has entered into a joint venture with Olympia and York, the largest owner of office buildings in the U.S. At year-end 1984, the partnership, United Business Communications, had more than 20 million square feet under contract.

Customers are continuing to provide their own private microwave facilities whenever the economics and/or need for specialized services justify self-supply.

Fact: Over 2,300 organizations own private microwave facilities covering 342,000 route miles.

The pace of mergers, acquisitions, re-positioning, and churn among suppliers has quickened in response to the increase in competitive activities and the need to keep pace with marketable developments.

Resellers are moving toward becoming facilities-based carriers by building facilities, entering joint ventures, and negotiating long term facility leases, thereby gaining greater control of their own transmission costs.

Fact: In 1985, Allnet plans to route 75% of its traffic over its own facilities or over facilities obtained through long-term leases. Lexitel plans to route 60% of its traffic over its own facilities. (These two companies have recently announced plans to merge.)

Natural market forces are eliminating duplicative or inefficient use of resources, to consumers' benefit.

Fact: The MCI/SBS and Allnet/Lexitel merger announcements, followed by the Fibertrak decision to put their fiber optic network on hold, are examples of the natural tendencies toward economic efficiencies.

Mergers, acquisitions, and joint ventures allow companies to pool their resources, expand customer bases and geographic coverage, and position themselves for the future.

Fact: Some resellers are selling assets and customer bases to others. RCI Corp., a subsidiary of Rochester Telephone Corp., recently acquired the customers of Call U.S. based in Ithaca and Syracuse. NCR has sold its resale subsidiary to U.S. Telephone.

Fact: ITT Longer Distance bought over 14,000 customers from Telesaver in early 1985.

Fact: Advanced Telecommunication had announced agreement to purchase AmeriCall in August, 1985. The value of the deal is approximately \$3 million.

AT&T has no significant market power in this market.

Divestiture removed the perceived major source of AT&T's alleged market power: the "bottleneck" facilities.

Fact: In Judge Greene's view, "With the removal of these barriers . . . , AT&T should be unable to engage in monopoly pricing in any market. . . ."

Fact: The National Telecommunications and Information Administration, following its investigation into the telecommunications industry, concluded, "We see no factor [in the market] providing AT&T or any other carrier a hook on which to hang a sustainable monopoly."

The new AT&T is drastically reduced in size compared to the pre-divestiture Bell System.

Fact: At the time of divestiture, AT&T-C's net plant was \$11.38, compared to its competitors' estimated net plant of \$5-6B—and that difference has rapidly diminished.

Market share data, while not an appropriate measure of market power, also indicates that AT&T does not hold the overwhelming share others have alleged it has.

Fact: AT&T accounted for only about 63% of industry's 1984 domestic toll revenues.

Because of the changing industry structure, the issue of whether long distance telecommunications is a natural monopoly has become moot.

Network costs—the only area where economies of scale can even be alleged to exist—now represent only a small part of the industry's long-term cost structure.

Fact: In its Comments in CC Docket 63-1147, United Telecomm Communications Inc. estimated its long-term cost structure (which doesn't deviate significantly from

AT&T Communications' structure today) as: 60% local access charges; 30% billing, Marketing and other overheads; 10% network.

Fact: As to access, the MFJ and the FCC guarantee that AT&T's competitors pay no more, and today proportionally less, than AT&T for local access.

Fact: As to billing, any vendor can obtain open billing from the BOCs at the same cost as AT&T.

Recent technological advances put network economies of scale into doubt; however, even if they existed, the fact that they represent one tenth of AT&T's costs makes AT&T's overall cost advantage extremely small.

Fact: In its report, the NTIA concluded that "... with network costs representing only about 10 to 15 percent of the total cost, it is unlikely that any small economies of scale existing beyond a moderate scale of network operations could provide a basis for a sustained long-distance monopoly."

Competition in telecommunications is not limited to domestic markets but has expanded into international arenas as well.

Competition in the switched voice market has evolved in just two years from where AT&T was the sole provider between the U.S. and other countries to the point where numerous carriers now offer service to over thirty countries.

Fact: As of August 1, 1985, MCI offers service to 30 countries representing 50% of the world's telephones. GTE Sprint serves 16 countries.

Fact: MCI plans to serve 80% of the international market by the end of 1985.

Fact: MCI has announced on several occasions that its international traffic has exceeded projections.

Fact: Canada is the largest source of international telecommunications revenues. MCI, GTE Sprint, SBS and several resellers all offer switched voice service to this country. Allnet, the largest reseller, was given authority by the FCC in August to serve Canada.

Value Added Network Carriers offer extensive international connections.

Fact: GTE Telenet's global data network extends to over 50 countries.

Fact: This Spring, General Electric Information Services Co. (GEISCO) made agreements with several International Record Carriers to make their VAN, Mark Net, available in the countries they serve.

New international services are being offered.

Fact: Intelsat Business Service (IBS), a private line voice and data service, is being offered or will be offered by at least 19 different companies, including MCI, SBS, Comsat, Argo and Hughes. IBS will allow competitors to offer a wide range of private line digital services such as teleconferencing, high speed facsimile bulk data transfer and digital voice.

New suppliers of international transmission facilities are emerging.

Fact: Two private transatlantic fiber cables have been proposed and landing rights have been approved by the FCC. Market Link (a joint venture between Cable and Wireless and Tel Optik) and Submarine Lightwave Cable plan to have their cables in operation in 1989. Market Link has announced that its system, when complete, will have up to three times the capacity of TAT-8 while the SLC system is designed to have up to twelve times the capacity of TAT-8.

Fact: Six private firms—RCA Americom, International Satellite, Inc., Pan Am Sat, Cygnus, Orion and Finansat—plan to build international satellite systems that will provide facilities to large users over heavily traveled routes. The first three firms were conditionally approved by the FCC in July.

Telecommunications is rapidly evolving from a distinct industry into a key, indistinguishable component of the Information Movement and Management (IM&M) market.

From both a technological and applications viewpoint, it is becoming increasingly difficult to distinguish between data processing and telecommunications.

Fact: The FCC, in its Notice of Proposed Rulemaking in CC Docket 85-229, stated, "There is now no fundamental difference between the technology of communications and that of data processing. Technology used in what is generally thought of as data processing often is used to transfer information among terminals and other peripheral devices in a manner analogous to the transfer of information among telephones. The computers used in a digital telephone switch are not significantly different from the computers used in data processing, and both can and do implement the same processing functions."

Data processing firms are recognizing the importance of telecommunications as part of their IM&M strategies.

Fact: IBM is selling most of SBS's assets to MCI, the largest OCC, in return for 16% of MCI's stock. IBM, the market leader in mainframes and personal computers,

now has the largest stake in the leading OCC as well as ownership of a leading PBX manufacturer (Rolm).

Fact: In 1984, Uninet (a Value Added Network owned by United Telecom) and Control Data Corp. established a joint technology venture to develop state-of-the-art networking systems.

Systems integrators are developing relationships with telecommunications providers.

Fact: Martin Marietta has recently purchased 25% of Equatorial Communications, a firm that specializes in turn-key private satellite data networks.

Conclusion

As these facts demonstrate, there is intense competition among numerous suppliers, including financially powerful companies. While there can be no guarantees that all will survive the rigors of the marketplace, the industry structure and market forces will ensure that competition prospers. Certainly, no single supplier is dominant. Public policy should reflect these facts, and the regulatory constraints which prevent the benefits of fair competition from reaching customers should be eliminated. In the final analysis, all consumers are the true beneficiaries of a freely competitive marketplace but also are the losers if the marketplace is not permitted to function in a free and evenhanded fashion.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR GOLDWATER AND THE ANSWERS

Question. Do you believe the interstate, long-distance market is competitive?

Answer. AT&T believes that the long-distance market exhibits all the characteristics of a rivalrous marketplace. By all relevant standards—growth of competitors' subscribers, assets, and revenues; number of competing providers; absence of barriers to entry and exit; competitors' successes in targeted markets; marketplace perceptions; and relative network capacity—the competitive interexchange carriers have grown very quickly and are backed by the ample resources of their parent companies.

Today, 80 percent of all telephone customers are offered service by two or more long-distance carriers. Competitors serve five million customers and earn more than five billion dollars a year in long-distance revenues. In the lucrative low-cost, high profit segments of the market they want to capture, competitors have substantial market presence. AT&T's competitors have signed up nearly half of the targeted business customers who spend more than \$50 a month on long-distance service, a customer group which accounts for 90 percent of interstate long-distance business revenues. In the residential market, competitors serve one in five targeted customers who spend more than \$25 a month for interstate calls and one in three of those who spend \$100 or more a month.

MCI and GTE have increased their investment in network facilities to \$1 billion each in 1985 alone—individually almost matching AT&T's investment. They have also rapidly expanded their international services. MCI now provides service to 30 foreign countries with 50% of the world's telephones.

The interstate long distance market, however, is not fully competitive in terms of the level of regulation imposed by the Federal Communications Commission. AT&T remains under full traditional rate base, rate of return public utility regulation, whereas our competitors enjoy forbearance from such regulation. Such traditional public utility regulation, imposed on AT&T alone among the interstate carriers, has stifled AT&T's innovative service offerings and significantly increased AT&T's costs. The OCCs use the regulatory process as a competitive tool, and by preventing AT&T from introducing its new services and pricing plans, they deny benefits to AT&T's customers they do not wish to serve, such as residents of rural areas. Unequal regulation is inconsistent with the vigorous competition that now exists in the interstate long distance market.

Question. What is your share of the interLATA telecommunications market? What is your share if you do not include resold traffic?

Answer. (a) AT&T's 1984 market share of the interLATA traffic is estimated to have been 83.5 percent. However, this figure is misleading since it includes, among other factors, 100 percent of the market which the other carriers do not want to

serve. AT&T's market share of total domestic long distance is estimated by the department of Commerce¹ and the FCC² to be between 63.5 to 65 percent.

Great caution must be exercised in using all market share numbers because there are so many measurements available and many market definitions from which to choose. Although AT&T's competitors have argued that AT&T still "monopolizes" the interstate market, market share is not a measure of "monopoly" or market power. Any single number taken out of context would tell little about such other important indicia of "monopoly" or market control such as growth, relative changes in investment, number of suppliers and profitability.

(b) One of the major changes in the competitive market place is that no company, not even AT&T, has complete data on the interexchange market. The OCCs consider their own facilities to be proprietary information. In recent hearings before the Communications Subcommittee, MCI estimated that 96.5 percent of its traffic is carried on its own network, which may indicate that the resold share of the other major facilities-based OCCs may also be relatively small.

There are two other ways of looking at this issue of market share. From the perspective of the end user, it is irrelevant where the facilities were obtained. Although the facilities may be AT&T's, the customer's point of contact is the reseller. Thus it is inappropriate to assign the revenue both to AT&T and the reseller. If the appropriate assignment to the reseller were made and double counting were eliminated, AT&T's market share would be sharply reduced.

Second, from the perspective of interLATA suppliers, the more relevant factor is industry capacity. If AT&T were to raise its prices to resellers, they would utilize other carriers' facilities. AT&T thus lacks market power, and the construction of new fiber optic networks by bulk vendors and the OCCs renders meaningless any argument predicated on capacity limits.³

Question. You have argued that AT&T should be given more flexibility in setting its rates. Why do you believe that the FCC should give you rate flexibility now, before the transition to equal access is complete?

Answer. The answer is treated extensively in our written statement and appendix and in filings with the FCC. Our position can be summarized briefly.

(1) Unequal regulation results in "managed" competition that skews any benefits towards OCC shareholders and hurts AT&T's customers, especially those without alternatives such as rural users. Since AT&T is handicapped and the OCCs are protected, there is less competitive pressure on their rates and great incentive for them to flow these benefits to their shareholders rather than their customers.

(2) Unequal regulation extracts significant costs from all users by inhibiting full marketplace competition. It prevents AT&T from responding to competitors' rates and from introducing innovative services and pricing plans. Unequal regulation and the OCC subsidy artificially inflate AT&T's prices and allow the OCCs to price their services not on their discounted costs, but rather on AT&T's government-controlled rates. The higher prices and suspension of AT&T's services have the effect of making U.S. industry less competitive in the global arena.

(3) Full public utility regulation is inconsistent with the current rivalrous marketplace, which would govern the industry far more efficiently than regulation. The market in long distance is highly competitive. Continuation of full regulation will perpetuate inefficiency throughout the industry.

(4) Elimination of burdensome regulatory requirements will speed innovation, reduce costs, and lower prices.

(5) Pricing options are popular with the public. "Reach our America", which our competitors delayed for months, has attracted 1.7 million customers in 13 months. Intrastate "Reach out" type plans have been approved in over 80 percent of the states where filed and "Pro America" type plans for small businesses are already effective in seventy-five percent of the states.

In summary, rate flexibility and reduced regulation will bring the benefits of competition to the public.

Question. Have you priced, or do you intend to price, any AT&T services below the price you pay for local connections, that is, below the tariffed rates for interstate local exchange access?

Answer. AT&T has not priced, nor does it intend to price a service to yield revenues less than its costs, including the aggregate charges for local connections for that service.

¹ NTIA, "Issues in Domestic Telecommunications" (July, 1985) at 85.

² Statement of Mark Fowler, Chairman of the Federal Communications Commission, Senate Subcommittee on Communications, September 11, 1985, at 4.

³ See NTIA Report at 25.

Question. What have the prices been for AT&T's stock for the last 10 years?
Answer.

AT&T COMMON STOCK PRICES

(Closing composite prices)

	Dec. 31	Bell System	Adjusted AT&T [28.50%]	New AT&T
1975.....		\$50.875	\$14.499	
1976.....		63.500	18.098	
1977.....		60.500	17.243	
1978.....		60.500	17.243	
1979.....		52.125	14.856	
1980.....		47.875	13.644	
1981.....		58.750	16.744	
1982.....		59.375	16.922	
1983.....		61.500	17.528	¹ \$17.875
1984.....				19.500
1985 (Oct. 3).....				21.250

¹ When issued.

Note.—Adjustment factor (28.50 percent) is official divestiture ratio based on an average of both Dec. 31 and Jan. 2 prices.

Source: AT&T Investor Relations, Oct. 4, 1985.

QUESTIONS OF SENATOR HOLLINGS AND THE ANSWERS

Question. It seems to me your unregulated subsidiary, AT&T-IS, sells almost all products and services a customer would want. Is this correct? If the separate subsidiary requirement ends, what additional services would the user have access to?

Answer. Under the provision of CI-II, AT&T Information Systems has provided customer premise equipment and enhanced services (processing, storing and changing information in the network). The relief granted by the Federal Communications Commission in its September 18th decision will enable AT&T Information Systems and AT&T Communications to jointly market network services and customer premise equipment. It is an important step toward loosening regulatory restrictions that unfairly apply to AT&T but not to its domestic and foreign competitors. For AT&T's customers it will mean better service. In the future, business customers, consumers and the U.S. Government will be better able to do business with us as we are positioned to work together to offer customers a fully integrated approach to their equipment and network service needs, and when desirable, one point of contact with the company.

Question. The CWA last week testified that many of your recent layoffs were due to your moving operations overseas. What operations have been moved, and what future plans do you have?

Answer. AT&T's recent layoffs are the result of market conditions and are not directly related to our overseas operations. AT&T has announced the establishment of a telephone set manufacturing facility in Singapore. As manufacturing is phased into the Singapore plant over the next 15 to 18 months, all residence telephone manufacturing at the Shreveport, Louisiana plant will be phased out. As we have stated before, to be competitive in today's marketplace, we need to continue to provide quality products at prices customers will pay.

Question. How much of its U.S. made products does AT&T export overseas? How much equipment does AT&T import? Does it import products that are available in the U.S.?

Answer. AT&T today exports a very small percentage of its total U.S. production, however, almost all of our telecommunications product needs for international sales are satisfied by U.S. made products. As a global competitor in the information industry, AT&T is committed to designing, manufacturing and managing complex, interactive systems that bring communications and data processing technologies together to meet the needs of the marketplace and its individual customers at a competitive cost. Success in this endeavor dictates that the Company analyze every business opportunity to maximize its return on investments, domestically as well as internationally. Every opportunity to improve our cost position through off-shore sourcing offers a corresponding opportunity to maintain a competitive position in the domestic market. Therefore, the products and components we import do and will

continue to vary with customer needs, market demands, and cost/production efficiencies.

Question. Does AT&T make residential telephones in the U.S. anymore?

Answer. Yes, residence telephones are manufactured at AT&T's facility in Shreveport, Louisiana.

Question. What joint ventures does AT&T have overseas? Do any of these ventures purchase U.S. made products? Will any of these ventures import into the U.S. foreign products?

Answer. In order for AT&T to succeed in the international market, we have formed several joint ventures. Our strategic alliances give us timely market entry, in-country expertise, and established ways of operating that eliminate the high costs of starting from scratch. AT&T has the following joint venture:

Gold Star Semiconductor—AT&T and the Lucky Gold Star Group of the Republic of Korea.

Gold Star Fiber Optic—AT&T and the Lucky Gold Star Group.

AT&T and Philips Telecommunications (APT)—AT&T and the Netherlands' N.V. Philips Company.

AT&T Micro Electronic de Espana—AT&T and Telefonica, the Spanish Telephone Company.

Western Electric Saudi Arabia (WESA)—AT&T International and A.S. Bugshan Brother.

UNIX Europe—AT&T and Olivetti.

Japan Ens Corporation—AT&T and 23 Japanese Corporations.

All of our joint venture companies purchase some U.S. made products and/or component parts. In all cases the products and services provided through our joint ventures are for marketing in locations other than the United States.

Senator GOLDWATER. Thank you very much, Mr. Brown.

Mr. McGowan?

Mr. McGOWAN. Mr. Chairman, I appreciate the interest of this committee in realizing our national goal of full and fair competition in the telecommunications industry. The transition to a fully competitive telecommunications market is now almost 2 years old. A key element, the key element in the transition, the provision to all long distance carriers of equal access to local exchanges, has been under way for a little over 1 year. We have discovered that many of the early assumptions and judgments were not necessarily correct.

The purpose of this hearing is exploratory, and I am not here to point an accusatory finger. However, what we have learned should be a cause of concern to consumers, to Congress, to the FCC, and perhaps even to the courts.

First, there is the matter of the Bell operating companies. They appear to believe that the implementation of divestiture somehow lessened their obligation, in our opinion, to provide their customers with efficient and reasonably priced local exchange services. Instead, the Bell operating companies which have the power to make the transition to a fully competitive long distance market as painless as possible for our mutual customers, their customers and ours, have been more interested in finding investment opportunities for their newfound wealth than in properly managing the transition to equal access.

I think the cornerstone of the modified final judgment and equal access is the opportunity for consumers to choose their long distance company. Yet MCI has not found a single Bell operating company which has made an adequate process for the timely conversion of MCI services to customers who have actually chosen us to provide them that service. What we have discovered is a number of problems. For example, we have found that AT&T submitted false

orders for more than 200,000 telephone lines, a fact which AT&T attributes to computer error. Valid MCI customer orders were rejected by the Bell operating companies because of overly strict criteria, widespread inability on the part of the Bell operating companies to report even to us or to themselves on order processing and customer installations, postconversion billing continuing for AT&T for calls made by customers who had chosen MCI, and we and they presumably thought they were installed on MCI's network.

And the result has been widespread frustration and confusion for consumers, many of them blaming us for the problems that inherently belong with the Bell operating companies.

We must also consider the role of the FCC in this process. Congress and the courts correctly, I believe, have assigned responsibility for the oversight of the transition to a competitive environment to the Federal Communications Commission. I have no doubts that the FCC wants to encourage a viable, competitive marketplace, and I believe that the Commission would have an enormous beneficial impact on making divestiture work if it would stop pretending, as we have heard here today, that everything is all right.

Not only is the FCC tinkering with telecommunications policy without any real understanding of the adverse impacts on full and fair competition, but it has also caught a very bad case of deregulationitis. AT&T continues to exert monopoly power over the marketplace. In the market we are talking about, interstate and long distance telephone service, AT&T has 85 percent minimum and more likely 90 percent of the long distance market in the United States. In practical terms, this means AT&T continues to dominate this industry to a degree unheard of in any other business sector.

Nevertheless, AT&T has staged a relentless drive for total and immediate deregulation ever since divestiture. And the FCC has demonstrated that it intends to comply if not in one sweeping pronouncement where it can be seen, then through a series of ad hoc or de factor deregulatory steps. Through FCC decisions over the past 15 months, AT&T is successfully marketing Opportunity Calling and Reach Out America. AT&T can now resell basic telecommunications services through its information systems subsidiary, and the lead time for its tariff filings has been reduced by half.

In addition, the FCC has proposed new cost standards in its flexible pricing rulemaking that would make oversight of AT&T's rates virtually impossible. Encouraged by these steps, AT&T has proposed yet another anticompetitive service, robed again in patriotic title, ProAmerica. This is a predatory offering priced below any measure of out-of-pocket cost.

Let's suppose AT&T were deregulated tomorrow as it wishes to be. It could—at its choice—double its prices in any state in the country without any regulatory constraint. Customers would say, "I'm going to change my service to MCI or another company." MCI itself would be thrilled. We could double or even triple the number of customers we have today. But that would be it.

All of the competing carriers could not handle—in our opinion—more than 20 percent of the total traffic in the long distance market that we are talking about. MCI does not have enough capacity, nor do the other long distance companies, and this is so even though we have been investing about \$1 billion a year in com-

munications network. The telecommunications services industry is an extremely capital intensive business. It takes years of planning.

So the reality of the situation is that the remaining 80 percent of the traffic in any area of the country would have to pay AT&T's higher rates. They would have no choice. I think that is a classic model of an industry that still needs government regulation to protect consumers, the vast majority of whom have no choice but to go along with AT&T if it decides to flex its muscle.

Deregulate AT&T? Yes, but eventually. I think we have to recognize realistically that the time is not now. Yet the FCC is so caught up with worrying about who is playing Chicken Little that it is making ad hoc deregulatory decisions without regard to market reality.

In conclusion, let's keep in mind that we are engaged in effecting a transition to competition. We are not there yet. What I have been talking about is the reality of the telecommunications marketplace, a reality that most of the people setting up the ground rules are ignoring.

In my opinion, we as a nation have some important decisions to make about telecommunications. We must recognize that a fully competitive telecommunications market will remain just an unrealized ideal unless we all work toward it, including investigation into the policies of the process now in place and correction of those policies where needed.

We must recognize that a carefully monitored transition period, including continued regulation of AT&T, is necessary to counteract the effects of 100 years of AT&T's monopoly.

We must recognize the need to ensure that the Bell Operating Cos. live up to their commitment under the consent decree to make the provision of efficient and speedy conversion to equal interconnection for all long-distance carriers their highest priority as companies.

And we must recognize the need to ensure that the FCC fulfills its assignment from the Congress and the courts, to make sure we achieve full competition in this industry.

When the Federal Government and the courts decided to open up telecommunications to this country's tradition of competition, they made a very far reaching decision. I believe that decision will be good for the U.S. economy. I think it will bring new jobs, new wealth, and make a major contribution to U.S. international competition.

I think that will be the fact that the history books will write about. It is up to us to see that, when it is written, it reports a success.

Thank you, Mr. Chairman.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR GOLDWATER AND THE ANSWERS

Question. About what percent of the market do you have now? What percent will you have after your transaction with IBM and Satellite Business Systems?

Answer. InterLATA market share data vary widely because of assumptions used and bases for computation. That said, most observers place MCI's interLATA market share range at between 5% and 6%. Steven G. Chrust of Sanford C. Bernstein & Co., Inc., writing in November 1984, based his calculations on billings of

minutes carried during that year. He estimates that AT&T carried 103 billion minutes, or 86% of interLATA traffic, and that MCI carried 6.8 billion minutes, or 5.6% of interLATA traffic.

Charles W. Schelke of Smith Barney Research, writing in March of 1985, based his calculations on gross revenues of interLATA traffic for 1984. He estimates that AT&T's gross interLATA revenues were \$34.3 billion, or 88.6% of the interLATA market, and that MCI's revenues were \$2 billion, or 5.2% of the interLATA market.

Neither Chrust nor Schelke attributes market share to the local exchange carriers, both BOC and non-Bell. NTIA, in its Study on Domestic Telecommunications issues, released July 1985, attributes 2.3% of interLATA revenues for calendar 1984 to the local exchange industry. If this inclusion is correct, NTIA's results are the most conservative in terms of relative market share for the IXC's, and thus, perhaps, the most appropriate basis for response to the question of interLATA market share for 1984. Based on total interLATA revenues of \$39.1 billion, NTIA attributes \$33.25 billion in revenues to AT&T (85% market share), \$4.95 billion in revenues to the OCCs (12.7% market share), and \$900 million in revenues to the LECs—both Bell and non-Bell (2.3% market share).

Using these figures, MCI reported revenues of \$1.96 billion during calendar 1984, representing an interLATA market share of 5.0%. For the same year, Satellite Business Systems (SBS) recorded revenues of \$290 million, representing a relevant market share of 0.7%. MCI proposes to acquire substantially all the assets of SBS from IBM. Assuming that acquisition had been effective from January 1, 1984, MCI's revenues for the year would have been \$2.25 billion, and its share of the interLATA market would have been 5.7%.

Naturally, MCI's acquisition of SBS would in no way have reduced AT&T's market dominance, which, as we see, is estimated to range between 85% and 88.6% according to informed observers of the domestic telecommunications marketplace.

Question. What effect will the SBS/MCI/IBM transaction have on competition?

Answer. The acquisition of SBS by MCI will combine MCI's approximate 1984 share of the interLATA market—5%—with SBS' 1984 share of the relevant market—approximately 0.7%—to produce a combined market share of 5.7% for MCI.

The proposed transaction will serve the interests of consumers of telecommunications services by enabling MCI and SBS to combine their technical expertise and forge financially stronger, more efficient entities. The integrated enterprises will be able to concentrate more of their resources on providing better quality services that consumers demand. Thus, the transaction will bring about important public benefits not only to the present subscribers of SBS and MCI, but for many consumers who do not presently subscribe to either of the carriers' services.

AT&T's dominant market share will not be affected by MCI's acquisition of SBS.

Question. Will you serve rural residents?

Answer. MCI already does provide rural residential service, and it does so in much the same way as AT&T. It receives rural traffic from local exchange carriers—both Bell and non-Bell—and relays that traffic to the local exchange carrier serving the destination community. Generally speaking, neither MCI nor AT&T originates or terminates the long distance transmissions it handles. These services are performed by the local carriers at either end of a long distance call.

To analogize with the airline industry, both MCI and AT&T operate intercity trunk fleets among airports. Passengers are brought to and from those airports by buses, cars, taxis. The airlines do not own the local distribution vehicles. They own the planes that take the passengers from one airport to any of the others.

In telecommunications, the buses, cars, and taxis are owned by the local exchange carriers. The airports are the terminals or toll offices of the interexchange long distance carriers. The airplanes are the capacity of those long distance companies.

Through its 100 years of history, AT&T reached agreement with virtually all the local exchange carriers to have traffic brought to its airports, its toll offices. It did this through its outright ownership of the Bell Operating Companies prior to divestiture, or through financial arrangements established with the non-Bell companies over the years. MCI has never owned a local exchange carrier. It is now in the process of growing to take advantage of the opportunities established by the Modification of Final Judgment and the access charge concept. Only 20 months after divestiture, MCI has a Point of Presence in 111 of the 162 Bell Operating Company LATAs. Under the provisions of the Modification of Final Judgment, toll traffic may be delivered to MCI's Point of Presence from anywhere in the LATA. MCI pays all the costs associated with the delivery of this traffic. As local telephone companies in rural areas convert to equal access, and as access tandem switches are installed, MCI will be in a position to serve more and more of the rural market.

AT&T already has equal access everywhere, thanks to generations of headstart, funded by monopoly ratepayers. Universal equal access is the goal toward which MCI is headed, fueled by the desire to compete head-to-head with AT&T in the interLATA telecommunications service market.

It should be noted that AT&T does not have universal origination any more than MCI has universal origination. AT&T has arrangements with the local telephone exchange industry that afford it traffic from everywhere. Parity with that position is MCI's goal.

And, as an earnest on that goal's fulfillment, MCI plans to have in place Points in Presence in 135 of the Bell LATAs by yearend 1985. That is 83% coverage for originating traffic from all the Bell service areas. MCI has already, of course, universal termination.

The pacing of MCI's rural coverage is simply a question of time and the willingness of the local exchange industry to recognize the sound business sense of providing equal access to Other Common Carriers, such as MCI; it is not a question of selectively picking and choosing areas of originating toll service.

Question. What's wrong with letting AT&T cut its prices? Isn't that supposed to be one of the benefits of the divestiture?

Answer. Nothing is wrong with letting AT&T cut its prices as long as those price cuts are cost-based, reasonable and non-discriminatory. However, AT&T has targeted below-cost offerings like Reach Out America (in effect) and PRO America (rejected for inadequate cost data) to selected customer classes, thus favoring them over all other subscribers. To the extent that these offerings to preferred customers are priced below their cost of service, other subscribers—who cannot benefit from the preferential offerings—may be forced to offset those losses. Historically, AT&T has argued that any place there is competition, its costs of service are lower. Where there is no competition, its costs of service are higher. Historically, this claim has been rejected as totally undemonstrated and unsubstantiated by the Federal Communications Commission.

Some AT&T long distance rates have gone down. As the carrier access line charge is reduced by the transfer back of local costs from long distance users to local subscribers, these savings are being reflected in some lower AT&T long distance rates. But, where little or no competition exists, some of AT&T's long distance rates have actually increased. Competition will eventually result in lower costs for all consumers if AT&T is prevented from targeting below-costs prices at evolving competition.

Question. What effect would AT&T's Pro America tariff and the FCC's proposed flexible pricing guidelines have on competition?

Answer. In that PRO America is priced below cost, it is predatory. AT&T's market power permits it to price below cost. Its cash flow permits it to keep preferentially targeted offerings in place long enough to drive its competitors out of those market segments—and prevent others from entering. Once there is no longer any competition, AT&T can raise the prices of the discriminatory services to meet, or substantially exceed, their cost of provision. This is a prime demonstration of monopolist behavior. And it could not come at a worse possible time—at a critical point in the transition to equal access.

AT&T has all the pricing flexibility it needs right now. If it discovers, for instance, that its costs of providing a specific service, e.g., MTS—regular dial-up long distance service—WATS—discounted regular dial-up service—or private line—flat-fee dedicated service—have changed, all it has to do is furnish the appropriate data to the FCC for a rate increase or reduction, which ever is warranted by the changed circumstances. The FCC can then evaluate the reasonableness and lawfulness of the proposed changes.

What AT&T wants to do, and what flexible pricing would allow, is for it to pick and choose the beneficiaries of its largesse, and thus discourage the growth of competitive alternatives.

Question. What actions on the part of the FCC are necessary for the development of a competitive market?

Answer. As Commissioner Rivera testified before the Subcommittee on September 11, the FCC needs to act in a coordinated fashion while it considers the long-run deregulation of AT&T. Right now, though there is a formal FCC proceeding precisely addressing the issue, there is no FCC master plan for AT&T deregulation. There is only an AT&T master plan for AT&T deregulation.

The FCC must develop its own master plan that establishes the transitional guidelines and safeguards for consumers as the telecommunications services market shifts from regulated monopoly to deregulated competition.

All issues affecting AT&T deregulation should be considered within a single context so that Commission actions and their effects on consumers and competitors are visible and understood.

MCI was encouraged by the FCC's unanimous rejection of AT&T's uncost-justified PRO America tariff on September 18. But, that action was not taken consistent with an overall review of AT&T's pricing practices, or the underlying costs of service which Senator Hollings rightly identifies as the threshold issue.

The Commission is not looking at the problem in this way. Congress needs to ensure that we make the journey from monopoly to competition in a way that truly benefits the American people.

The CHAIRMAN. [presiding]. Thank you, Mr. McGowan.

Mr. Brophy.

Mr. BROPHY. Mr. Chairman, I am pleased to have this opportunity to appear before you today and testify on the prospects of competition in the long-distance telephone service. The committee has shown great wisdom in holding these hearings on this important subject. I will summarize my prepared statement which I understand will be included in the record.

This Nation's interests lie in guaranteeing the survival of competition, not of any one competitor. Competition provides the consumer with choices, technological innovations and lower long-term prices. Creating effective competition in intercity telecommunications which has been a Government-created monopoly for so long is an extremely complex undertaking. Deregulation of airlines and railroads does not serve as a precedent to guide our action. In those instances there were many robust competitors of approximately equal size. One needed only to deregulate the industry.

In the long-distance telephone business the industry must first be demonopolized before it can be deregulated. I am here because I am concerned as to whether the Nation's telecommunications users will receive the benefits of full and effective long-term competition unless current Government policies are modified.

The principal reasons for my concern are twofold. First, at a critical time in the conversion to so-called equal access, the FCC has abandoned its prior practice of analyzing the relative value of the local interconnection arrangements that AT&T's competitors receive. Second, the objective of establishing a competitive intercity telecommunications market for the long-term benefit of consumers appears to have been replaced at the FCC by the goal of rapid deregulation of the dominant carrier, AT&T. The FCC has assumed erroneously that effective competition already exists.

The fundamental problem for AT&T's competitors has always been obtaining equal access to the local telephone exchanges. Because the national telephone network was originally designed to serve only one long-distance carrier, AT&T, the OCC's were originally obliged to accept inferior interconnection. The FCC at an early stage in the effort to create competition expressly recognized that AT&T's premium interconnection was clearly more valuable than that of the OCC's, absent other compensating factors. Competition could not develop in the face of this inequality. Therefore, the Commission found that it would be harmful to the public interest to require the OCC's to pay the same access rates for this inferior interconnection as AT&T paid for the superior interconnection.

The interconnection problem became more complicated in 1982 with the AT&T consent decree. This decree required divested Bell

Operating Cos., to redesign their local networks to provide to the OCC's over a multiyear schedule a new form of access more akin to that given to AT&T. Thus, for an extended period of time, the OCC's are required to use two different forms of access, and the FCC, despite its earlier recognition of the competitive significance of a lower valued OCC interconnection, and without any explanation, declined to compare the economic value of the OCCs' equal access arrangements to AT&T's interconnections. Instead, the FCC merely assumed parity between the two.

As a result, the OCC's today must pay the same rates as AT&T does for this new access even though the real value of that access they receive is far less. It is less because only the OCC's, not AT&T, must bear the heavy cost of network conversion, the burden of marketing such service to potential subscribers, and the numerous other problems that are described in my written testimony.

The unfairness of the situation is obvious. Access charges represent more than 50 percent of all the long-distance carriers' total costs, and the detrimental impact on competition is overwhelming.

The threat to the development of competition has been heightened substantially by the FCC's desire to deregulate AT&T as soon as possible. Despite such evidence as the recent mergers and the fact that no facilities-based OCC is currently earning anywhere near its cost of capital, the FCC has convinced itself that vigorous competition already exists in the long-distance marketplace. As a result, the FCC has permitted AT&T to offer services through unregulated means, to file tariffs with insufficient economic support and inadequate notice period.

For all of these reasons, the OCC's petitioned the FCC to review the entire transitional process. Unfortunately, the FCC's response to date raises doubts regarding the likelihood of a fair hearing. Remarks by the FCC staff indicated that our problems are being trivialized. A recent edition of *Business Week* noted that our request for a review of the entire situation appears to be falling on deaf ears at the FCC.

What I ask of you today is to exercise your oversight powers to require the FCC to analyze the issues raised by the OCC's and develop an effective transition plan. Time is of the essence. If the FCC fails to adopt an effective transition plan quickly, then Congress may well have to mandate such a plan through legislation.

The citizens of this country have a right to receive the myriad benefits that competition can offer, but what a great misfortune it would be if the hoped-for consumer benefits were never really realized.

Thank you.

[The statement follows:]

STATEMENT OF THEODORE F. BROPHY, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, GTE CORP.

Mr. Chairman, Senators. I appreciate having this opportunity to discuss with you my perspective on the prospects for competition in long distance services. The importance of this issue stems from the great potential for widespread consumer benefits which a properly functioning marketplace offers. Unhappily, I must report that I am concerned about the development of effective long-term competition unless current government policies are modified.

AT&T's long-standing dominance of the nation's telecommunications field, both in terms of market share and unique technical and operational capabilities, renders the long distance telephone industry quite dissimilar from other businesses, such as airlines and railroads. As a result, it has been widely recognized that mere open entry and deregulation would not produce a competitive marketplace as it has in some other areas; rather the FCC need to develop and monitor a transition plan in order to ensure the development of truly effective competition.

Recently, the FCC seems to have backed away from its proper role by ignoring serious problems which have arisen in the transition process and adopting a policy of deregulation regardless of the state of long distance competition. Such actions inevitably will impede the development of an effective marketplace.

The principal reasons for my opinion are twofold. First, at a critical time in the conversion to so called "equal access", the FCC has abandoned, without explanation, its prior practice of analyzing the relative value of the local interconnection arrangements that the other common carriers, or OCCs, receive as compared to AT&T. In the past, the Commission has been careful to recognize the competitive significance of the differences between the two types of interconnections and establish rates which allowed for the development of competition. However, in recent months the FCC has twice failed to address fully issues raised concerning the value of equal access to the OCCs. Instead, the agency simply has assumed that once the so-called "equal access" is made available to all carriers, they are receiving equal value. As I will detail shortly, this is not the case.

Second, the national objective of the last fifteen years—the establishment of a competitive telecommunications market for the long term benefit of consumers—has been replaced at the FCC, until recently without any public debate, by the goal of deregulation. Rather than ensuring that AT&T's market power is not used to retard competition, the FCC today seems unconcerned with the state of the marketplace and has assumed, erroneously I believe, that the marketplace is fully competitive. With your permission, I would like to spend a few minutes explaining why I have reluctantly reached these conclusions.

THE DEVELOPMENT OF A COMPETITIVE LONG DISTANCE MARKET HAS BEEN A LONG-STATED NATIONAL POLICY GOAL

Since the late 1960s, we have seen the development of a national policy supporting competition in the intercity telecommunications industry. This policy first appeared in 1969 when the FCC granted MCI's application to build a microwave system connecting Chicago and St. Louis for the provision of private line services similar to those offered by AT&T. Those services were called "private" because they were intended to be used only by a single entity—usually a business—and provided communications generally between pre-designated points, such as home offices and branch offices of a corporation.

By the middle of the following year, almost forty companies had applied for FCC approval to build such common carrier microwave systems. Each of the proposed networks sought to provide specialized common carrier services transmitting voice and data over private lines. The FCC noted that these specialized carrier applicants offered the potential to bring new services to the public in response to a dynamic, rapidly growing demand. The agency believed, as I do, that effective competition would encourage the rapid introduction of new technologies, provide consumers with a diversified choice of products and services, and hold down prices by stimulating participants to even greater efficiencies.

By the middle 1970s, many new carriers were seeking to provide not only private services but also services which competed more directly with the public long distance telephone network. These proposals provoked a long and heated policy debate. Ultimately, as we all know, the federal court of appeals here in Washington resolved the dispute in 1978 with its landmark *Execunet* decision, which opened public long distance telephone service to competition. Shortly thereafter, in 1980, the FCC ratified this open entry approach as the national telecommunications policy.

However, while the central role of competition had been determined, much more difficult questions concerning the transition from a monopoly industry to a competitive one remained unanswered. In particular, competitive problems were created by the fact that the OCCs had to interconnect with local exchange carriers in a manner which was vastly inferior to the arrangements provided to AT&T. In addition, AT&T's long held monopoly status endowed it with numerous advantages which gave it tremendous continuing market power.

Webster's first two definitions of a monopoly are (1) "exclusive control of a commodity or service in a given market, or control that makes possible . . . the virtual

elimination of free competition," and (2) "an exclusive privilege of engaging in a particular business . . . granted by a ruler or by the state." For many decades, AT&T's status clearly fell within both definitions.

In my view, the fact that AT&T's prior monopoly status was government sanctioned, rather than earned through its own competitive endeavors, is very significant in this policy debate. We are not seeking intervention in the workings of a competitive marketplace to advantage a competitor. On the contrary, we ask only for modification of prior and existing government policies which are hindering the establishment of a competitive marketplace.

THE FCC'S ACCESS CHARGE DECISIONS TRADITIONALLY HAVE RECOGNIZED THE POSSIBLE ANTICOMPETITIVE EFFECT OF THE INFERIORITY OF THE OCCS' INTERCONNECTIONS

The practical problem with obtaining interconnections to the local exchange was that the national telephone network had been developed as an integrated system designed for connection to only one long distance carrier—in effect, a substantial AT&T bias had been built into the network. The OCCs were thus obligated to use inferior interconnections, a fact which created a number of problems for them and their customers. In particular, OCC subscribers were required to dial 14 or 16 extra digits and to use touch-tone calling. At the same time, the inferior access arrangements did not allow the competitive carriers to know the origin of their subscribers' calls, or even whether they were answered. This lack of information resulted in billing problems and inefficient network design.

Consequently, a prolonged debate arose concerning the proper rates for these admittedly inferior interconnections. At an early stage in this controversy, the FCC recognized that the OCCs' access arrangements placed them at a competitive disadvantage when compared to AT&T. The agency expressly noted that "the premium interconnection that AT&T now enjoys is clearly more valuable than that offered to the OCCs." Significantly, it recognized that "this value arises as much from the inconvenience and expenses that AT&T can avoid as from the benefits it provides." In view of these considerations, the Commission found that it would be unfair to force the OCCs to pay the same access charge rates as AT&T when it was clear they were receiving inferior local access.

It is important to note here that, contrary to the assertions of some, the OCCs did not receive a discounted rate on their interconnections. On the contrary, the carriers were charged for the full value of their access arrangements. They paid less than AT&T for interconnections only because the service which they received was less valuable. As the Commission itself stated in a recent access charge decision, in order to understand the varying prices for the different types of local access being provided to AT&T and its competitors "it is necessary to understand the competitive effect of [the] technical differences on interexchange carriers' service offerings."

The interconnection dispute took a different turn when, in 1982, a consent decree was approved ending the Justice Department's antitrust suit against AT&T. As is well known, that action required AT&T to divest all the Bell Operating Companies. It also ordered those companies to redesign their local networks so as to give the OCCs a new form of interconnection termed "equal access" which was to be more akin to that given to AT&T. The intent was to resolve most of the earlier form of OCC interconnection, thereby reducing obstacles to competition. As a result, two forms of access became available to the OCCs, the then existing interconnections and the new so-called "equal access" arrangements similar to—but not necessarily identical with—the type that AT&T has always utilized.

Approval of the consent decree involved judicial action in a single case, not a determination derived from Congressional policy reflected in the Communication Act, nor the result of an expert agency oversight of an entire industry subject to Congressional guidance. Accordingly, the decree limited its definition of "equal access" to an AT&T proposed customer perception comparison, with no attempt to define or determine the economic value of "equal access" to the competing carriers. The court indicated that it had no problem with such an economic analysis but if any such review was appropriate, it was the task of the FCC. Judge Greene noted, "If there is no difference in the cost of providing these [existing access] services, it would be appropriate for charges to AT&T to be increased to reflect the higher quality connection. The Court . . . lacks the expertise and flexibility to determine the amount of such a premium, but regulators remain free to insist on such a premium, but regulators remain free to insist on such a differential."

Subsequent to the AT&T divestiture, the FCC announced a new scheme for compensating the local exchange carriers for use of their local telephone networks by interstate carriers. Coincident with the purpose of the consent decree, an explicit

goal of this new "access charge" policy was to achieve a competitive market structure.

THE COMMISSION HAS DECLINED TO MAINTAIN ITS POLICY OF REVIEWING THE COMPETITIVE EFFECT OF LOCAL ACCESS ARRANGEMENTS

Despite its earlier recognition of the competitive significance of the unequal OCC interconnections, the FCC has declined to analyze the economic value of the new "equal access" arrangements relative to AT&T's interconnections. Instead, at a critical stage in the transition to competition, the Commission has abandoned its careful analytic approach and merely adopted the consent decree's limited customer perception definition of equal access. As a practical matter, however, the equal access arrangements provided to the OCCs are far from "equal" to those of AT&T.

Similar access arrangements given to differently situated carriers cannot automatically be expected to result in equality of treatment. When equal access was defined, it is not surprising that AT&T's superior interconnections were chosen as the norm. However, this also meant that AT&T would not suffer the expenses and inconveniences of network conversions, the need to educate subscribers on how to use its network depending upon the form of access available and where the call originates, the need for access tandems, and most of the other problems now facing the OCCs. None of these differences is considered by a simple customer perception test.

I do not mean to suggest that the equal access process should have been established so that AT&T's access arrangements were degraded. That would have been impractical and, more importantly, poor public policy. What I am saying however, is that these advantages do exist and they must be taken into consideration when determining whether "equal access" is truly equal.

Having wrongly assumed that the connections the OCCs were to receive were of equal value to AT&T's in every regard, the FCC concluded that the price charged the OCCs and AT&T should be the same. Under the FCC's current plan, therefore, the OCCs pay the same as AT&T for access to the local exchange even though their interconnection arrangements are demonstrably inferior. The unfairness of this situation is obvious.

THE BOOZ, ALLEN AND HAMILTON STUDY CONFIRMS THE FINANCIAL PROBLEMS FACING THE OCCS

Compounding the detrimental effects of the Commission's decision to extinguish the access charge differential prematurely is the FCC's refusal to recognize the continuing need for vigilance against AT&T's unfair use of its remaining monopoly advantages. After a year of post-divestiture experience, we had serious concerns about the viability of competition in the long distance market. In order to assess the financial impact of the Commission's transitional policies on the OCCs, we commissioned Booz, Allen and Hamilton to analyze the situation.

The resulting study circumscribed the potential growth of competition by developing two scenarios: the first assumed that the the OCCs would capture all growth in the interexchange market over the next five years; the second was less optimistic and projected that the OCCs would capture one-half of the market's growth. In the former instance, the three OCCs studied (GTE Sprint, MCI, and Allnet) would be required to invest more than six billion dollars over the next five years in order to have networks sufficient to carry their assumed growth. Due to the financial burden stemming from the FCC's access policies, the study estimates that the carriers will realize average rates of return of approximately two percent for the five years. The latter scenario projects returns for the carriers of negative three percent in 1985 growing to a negative ten percent in 1989. With returns on risk-free government bonds valued at almost eight percent, such earnings will obviously make it difficult to justify sufficient investment to support the OCCs' growth.

The Booz Allen study confirmed our suspicions that the emerging competitive interexchange marketplace is threatened. For these reasons, we petitioned the Commission to return to its prior practice and recognize that the equality of access arrangements cannot be defined solely by the customer perception approach. The economic value of such arrangements also must be considered. As was noted in that OCC petition, the major issues that need to be addressed are the equal access implementation process and the competitive advantages which AT&T possesses now and after equal access.

THE TWO MAJOR ISSUES INVOLVED IN THE EQUAL ACCESS IMPLEMENTATION ARE ITS
PIECEMEAL PHASE-IN AND THE ABSENCE OF TANDEM SWITCHES

The implementation of the consent decree's requirement for "equal access" has given rise to a major set of problems which threatens the development of competition and lessens the economic value of that access to the OCCs. The current transition plan permits conversion to "equal access" on an end-office-by-end-office basis, as opposed to an area-wide basis. This practice leaves contiguous neighborhoods within a metropolitan area on unsynchronized conversion schedules. For example, in the Washington, D.C. area, parts of Arlington might be shifted to equal access while the rest of the metropolitan area, including much of Arlington itself, will not be converted until many months later.

What does this mean to me as a businessman when "equal access" comes to a neighborhood? Under the recently adopted allocation plan, subscribers will be asked to fill out a ballot to select a long distance carrier. GTE Sprint must then attempt to persuade those people to select Sprint over AT&T or another carrier. AT&T, on the other hand, has none of these disadvantages and needs only to convince consumers that no reason exists to change carriers.

The piecemeal implementation of equal access prevents us from making such efforts as effectively or as inexpensively as AT&T. Mass media is counterproductive in delivering information in these circumstances because many people who will view the advertising may not yet be served by a converted end-office. They will become confused or frustrated when they attempt to respond to the advertisement and discover that the service is unavailable to them. To avoid this situation, Sprint and other OCCs have been forced to rely principally on institutional advertising or specialized advertising techniques which are both more expensive and more likely to fail to reach all potential customers.

In addition, we must spend large sums to educate both new and current subscribers on how to use Sprint's services. As a result of piecemeal conversions, many customers travel or work in areas where the method of accessing Sprint will be different from that at their home. It is significant, therefore, that even those who master how to use our service in both equal and non-equal access areas probably will not know which type of access a particular location receives until the area-wide transition is completed.

AT&T and its subscribers, as I noted earlier, face none of these troubles. During this period of piecemeal conversions, AT&T's connections remain unchanged and of superior quality. These costs and inconveniences, as the Commission has noted previously, are burdens to Sprint and the other OCCs which must be taken into account if competition is to develop.

The current implementation process also contains several other flaws which require Sprint to incur extraordinary costs. For example, "equal access" will be introduced in many areas several months before the Bell Operating Companies install tandem switches. Tandem switches are switches which gather traffic from multiple end-offices. They allow a long distance company to save considerable expense by connecting with several end-offices at one location. In the absence of such switches, the OCCs are forced to connect directly to each and every end office, thus incurring increased installation, testing, and maintenance costs. The result is a less efficient network design. Moreover, when access tandems finally are installed, an additional network conversion process must occur. In contrast, AT&T will suffer no transitional expenses, thus amplifying the substantial cost advantage it has over its competitors. While I am pleased to report that the Bell Operating Companies have recognized the difficulties created by the absence of tandems and have begun to act to ameliorate the situation, the harm to competition will take longer to remedy.

Beyond the extra costs of piecemeal implementation and the lack of tandem switches, there are additional costs which Sprint must bear that AT&T does not. These relate to the need to utilize two switching configurations simultaneously, one for the "equal access" interconnections and one for the existing inferior access arrangements. Other significant problems which we face are detailed in our June 17 petition to the FCC.

In sum, under the current transition plan, Sprint and other OCCs have no alternative but to adopt temporary and costly measures to compensate for the many advantages held by AT&T. Despite these disadvantages, Sprint must pay the same price as AT&T for local access after conversion occurs. At the same time, however, its rates must stay well below those of AT&T because, in spite of these expenditures, a significant portion of Sprint calls will continue to use the inferior interconnections at one end or the other until nationwide conversion is virtually complete. Until

then, GTE Sprint will not receive the benefits of equal access which will enable it to offer more than price competition to AT&T.

AT&T DERIVES AN UNFAIR MARKET ADVANTAGE FROM ITS EXCLUSIVE CONTROL OVER CUSTOMER-USAGE DATA

Another major set of disadvantages faced by the OCCs results from the fact that AT&T alone possesses nearly complete usage information for marketing and network design purposes. Due to its former monopoly position, AT&T has the benefit of comprehensive historic and up-to-date usage information on 90 percent of all long distance traffic. As a consequence, AT&T has the exclusive ability to design new rate programs based on the precise needs and habitats of specific groups of consumers. Moreover, having had such information to create an offering, AT&T can use the same database for marketing purposes, identifying and contracting directly each and every user for whom it was designed.

By comparison, the OCCs have access to no historical usage information and only current data on the small percentage of the market which each of them individually serves. This relatively small base is not sufficient to enable them to engage in the type of targeted rate design activity which AT&T, with its 90 percent usage information, is now conducting. Our efforts are hindered further by the fact that in some instances AT&T will not allow the BOCs to release much needed information to the OCCs, and, in other situations, BOCs will not sell the OCCs the type of usage information required. In short, AT&T obtains a substantial rate design and marketing advantage from its sole possession of this usage data.

Such information also allows AT&T to design its facilities and systems with much greater accuracy than can its competitors. Knowledge of the amount of traffic from each local end office, as well as of peak times and loads from those locations, enables AT&T to ascertain the exact amount of facilities required. Unable to forecast traffic demands with the same precision, the competing carriers risk severe cost penalties by ordering excess facilities or poor service quality because of insufficient facilities. Again, AT&T realizes relatively lower costs and higher efficiency by this unfair information advantage which it possesses only by virtue of its prior monopoly status.

AT&T'S CONTROL OVER UNIQUE OPERATING SYSTEMS GIVES IT ADDITIONAL MARKET POWER

Another self-perpetuating aspect of AT&T's market power is its retention of exclusive possession of advanced operating systems paid for through monopoly ratepayer funds. This technology makes AT&T, as some of the BOCs have noted, effectively the only long distance company able to provide 800 Service, coin calling from pay telephones and automated credit card calling. AT&T's monopoly over these offerings, which generate billions of dollars in revenues annually, did not terminate upon the introduction of a policy of open entry, nor will it when the "equal access" implementation period ends. To reproduce these systems which AT&T developed in its monopoly era will require years of development and many millions of dollars.

The benefits of AT&T from these smaller monopolies include a substantial revenue source beyond competitive challenge, which is therefore available for cross-subsidization of competitive offerings, and the ability to market itself as the only carrier capable of providing a full line of services. AT&T, however, did not earn this advantage in the competitive arena, but in an era of regulated monopoly and ratepayer-funded research. Because the public financed the creation and development of these systems, it should receive the benefits which would come from opening the services to competition.

Beyond the transition flaws, AT&T's prior monopoly also will give it an indefinite advantage in access arrangements. Even after "equal access" has been fully implemented, a full 20 percent of the nation's telephones still will not be converted under any consent decree timetable. Areas in which these phones are located are exempt either because they are physically incapable of being converted or because the end offices contain fewer than 10,000 access lines. These locations are not strictly rural but include segments of a number of major metropolitan areas as well. Until conversion of those areas occurs, AT&T will remain the exclusive vendor of nationwide premium service.

THE PREMATURE DEREGULATIVE OF AT&T THREATENS A COMPETITIVE MARKETPLACE

That these monopoly advantages endure is only part of the problem. Their significance has been heightened substantially by the FCC's apparent desire to deregulate

AT&T as soon as possible. The agency has convinced itself that, as Chairman Fowler stated in the July 1 edition of *Business Week*, robust and vigorous competition already exists in the long distance marketplace.

This view ignores the fact that the adoption of an open entry policy cannot in itself guarantee competition in the telecommunications industry. For nearly a century, AT&T was the nation's sole supplier of long distance service. The industry thus is made unique by its continued domination by a company which has long held a *de facto* monopoly, combined with the need for all market entrants to provide service on a broad geographical basis from their inception and the fact that all of AT&T's competitors are dependent upon its facilities to some extent. As a result, other industries that have been deregulated, such as trucking or airlines, cannot serve as useful models in determining policy for the telecommunications market. Inevitably, if we are to be successful in attaining our objective of effective competition, the industry must go through a "demonopolization" period during which the impediments to effective competition which stem from AT&T's prior monopoly status begin to diminish.

Despite the continued existence of AT&T's market power, the FCC recently has taken a number of actions which allow AT&T even greater flexibility in exploiting its advantages. One important decision was to permit AT&T Information Systems ("ATTIS"), the AT&T company which provides enhanced communications services, telecommunications equipment and computer hardware and software, to provide basic services without regulatory supervision by reselling the offerings of AT&T Communications. Previously, the FCC's Second Computer Inquiry separation requirements limited ATTIS to providing computer-related "enhanced" services and customer premises equipment. This constraint stemmed from the belief that unregulated resale of "basic" services which it bought from its parent could be cross-subsidized by non-competitive services, could form the basis for anti-competitive actions, and could grant AT&T the ability to avoid regulatory oversight.

In conjunction with AT&T's continued domination of the industry, the FCC's removal of this prohibition grants the dominant carrier the ability to provide, through ATTIS, all services and equipment to the public on a detariffed, deregulated basis. The FCC justified this action by asserting the need to give AT&T the flexibility to counter competition.

In addition to adding the resale of basic services to the lists of unregulated AT&T activities, the FCC has reduced its oversight of those offerings which are still subject to regulation. It has done this by permitting AT&T tariff changes to take effect without investigation, even when its cost support is found to contain "serious flaws" and where grave concerns are recognized with respect to price discrimination through cross-subsidization.

For example, in April, 1984, AT&T filed a tariff to institute an optional calling plan popularly known as "Reach Out America." The proposal called for AT&T customers to purchase long distance service on an hourly basis: \$10 for the first hour in a given month and \$8.75, *pro rata*, for each additional hour. GTE, the Department of Justice and other petitioners objected on several grounds, including that the rate being offered to the public was even less than AT&T's payments to the local exchange companies for access for that service. The other costs of providing the service obviously made the analysis even worse. The OCCs pointed out that this below cost plan thus could only be sustained by anticompetitive measures such as cross-subsidization from other, less competitive services. Similarly, the Department of Justice expressed concerns about the plan and the concomitant anticompetitive dangers of granting AT&T excessive freedom in setting prices that are noncompensatory under existing arrangements with local exchange carriers.

The FCC recognized that the rate was likely to be below the cost of obtaining switched access service from local exchange carriers. Nevertheless, the Commission adopted the view that the plan merely represented a "simple, easy-to-understand billing arrangement." The FCC decided not even to investigate the service.

Last summer, AT&T filed another below cost tariff, this time for a service termed ACCUNET. Again, many parties petitioned the Commission and pointed out not only the below cost nature of the proposed service but also the potential cross-subsidization problem created by the fact that AT&T's resale entity, ATTIS, seemed to be the only customer for the service. The Commission agreed that petitioners had "identified serious flaws in [AT&T's] cost support data and raised questions regarding the proposed rates."

However, rather than rejecting or investigating the tariff, the Commission ignored the potential danger to competition and allowed it to become effective so as to "have the benefit of market experience in determining whether the demand projections are realistic and whether ACCUNET is properly priced to cover costs." Recently,

the Commission concluded that the tariff should be deleted because the concerns that were originally raised proved to be accurate. Although pleased with the ultimate outcome, we are concerned that the FCC believes it reasonable to determine whether an AT&T proposal will have anticompetitive effects by first putting it into effect. We know of no way to resurrect businesses bankrupted by such trial periods.

Another example of the FCC's recent deregulation efforts is its recent decision concerning the new Software Defined Network ("SDN") service. There, the Common Carrier Bureau heeded written complaints and suspended the tariff proposal. It then began an investigation into issues of rate discrimination, service bundling, and uneconomic bypass. Even though it had determined that "suspension of [AT&T's] proposed tariff revisions [was] necessary," the Bureau on its own motion offered to allow AT&T to offer SDN service on an "off-tariff basis".

The meaning of this "off-tariff" phraseology was made clear recently by a Common Carrier Bureau letter which granted AT&T authority to offer its SDN service to a user without filing a tariff at all. Thus, for the first time in its history, and despite its obvious domination of the market, AT&T Communications was given the authority to provide a basic communications service without filing a tariff.

As is clear from the above, the burden of persuasion in AT&T's tariff filing cases has been shifted from AT&T to the OCCs. As I noted earlier, the Commission has taken these actions in the name of "competitive necessity" or as a requirement to protect AT&T from the "potential competitive disadvantages" accompanying the need to file tariffs. In contrast, the new difficult competitive position of the OCCs as new entrants in a line of commerce traditionally dominated by one of the world's largest corporations has been, by and large, ignored.

It is for all of these reasons that GTE Sprint believed it was necessary to petition the FCC to review the entire access process. Unfortunately, the response that the FCC has given our filings and those of other petitioners on these issues raises doubts in my mind regarding the likelihood of a fair hearing at the Commission. In fact, harsh criticism by Commission officials recently has been directed toward our concerns and observations that the national policy of introducing effective competition in the interexchange market is in jeopardy. Remarks by FCC staff indicate that our problems are being trivialized and that the agency is more concerned with deregulation than with attaining competition.

Recently, the Chief of the Common Carrier Bureau, gave a speech on June 10 belittling our position and accusing the OCCs of squawking, like Chicken Little, that the sky is falling. That speech was followed a week later by a report from Mr. John Haring of the FCC's Office of Plans and Policy. Mr. Haring accused the OCCs of being extortionists. This FCC study alleges that the OCCs are threatening to fail so that they can obtain competitive advantages from the FCC. Not only is this untrue, but it is insulting.

Mr. Haring supports his argument by stating that a "failing competitor does not imply that competition is failing." As I have explained, however, this is not a case of an inefficient operator being weeded out by an effective marketplace. Rather it is an industry where competition now exists, to a large degree, in name only. Unless AT&T's numerous unearned advantages are counterbalanced, competition may indeed fail. The FCC, however, does not seem willing to consider the possibility that there may be a problem with competitive conditions in the long distance market. The same issue of Business Week which recorded Chairman Fowler's belief that meaningful competition already exists in the long distance market also noted that our requests for the institution of an investigation of the matter, "appear to be falling on deaf ears at the FCC, which seems determined to deregulate the long distance industry as soon as possible."

The deregulation of AT&T should depend upon whether the telecommunications industry can successfully move from a monopoly to a competitive market. I have reluctantly reached the conclusion that the FCC has lost sight of the policy it has been instrumental in creating over the past two decades: introducing effective competition in the interexchange marketplace. The federal government and the common carrier industry have come too far and have promised the public too much to turn back now. What I ask of you today is to exercise your oversight powers to ensure that the FCC carefully analyzes the issues that the OCC industry has raised and develops an effective transition plan to move the long distance industry toward a fully competitive status. Time is of the essence. If the FCC fails to adopt an effective transition plan quickly, then Congress may well have to mandate such a plan through legislation.

After having experienced the trauma, confusion and inconvenience of AT&T's divestiture, the citizens of this country have a right to receive the myriad benefits that competition offers. What a great misfortune it would be if the hoped for con-

sumer benefits were never realized. Conscientious debate, deliberation, and action on these matters, I am confident, will significantly contribute to the achievement of competition in the telecommunications industry.

Thank you.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR GOLDWATER AND THE ANSWERS

Question. If your petition to the FCC to amend the equal access transition plan is granted, will local rates increase as a result?

Answer. Absolutely not. The OCC petition will not put greater pressure, directly or indirectly, on local rates. The FCC access plan requires the interexchange carriers to pay the entire cost for interstate access. Thus, the local exchange carriers are guaranteed to receive sufficient revenues to cover all their interstate access revenue requirements. Nothing that GTE Sprint has recommended would change that aspect of the Commission's policy.

Nor would a grant of the OCC petition put indirect pressure on local rates by increasing carriers incentives to bypass the local exchange. This is so for two reasons. First, even if AT&T were required to pay the *entire* interstate access revenue requirement, the increased cost to AT&T would be so proportionately small that it would not require a noticeable rate increase, especially in light of AT&T declining costs. Second, since the increased charges to AT&T would be for a limited period of time, it would not be expected to make long term investment plans to avoid a temporary expense. In establishing AT&T's premium charge, the FCC reached this same conclusion.

Question. What actions on the part of the FCC are necessary for the development of a competitive market?

Answer. If a competitive marketplace is to develop, the FCC must do two things. First, it must return to its original policy of evaluating the relative competitive effect of the access arrangements offered to the OCCs and AT&T. Once this is accomplished, appropriate rates must be established to allow for the development of competition during this critical transitional period.

Second, the Agency must not deregulate AT&T prematurely. It must ensure that AT&T does not unfairly use its artificial advantages, stemming from existing and prior government policies to destroy the possibility of a truly competitive industry.

Question. What effect would AT&T's "Pro America" tariff and the FCC's proposed flexible pricing guidelines have on competition?

Answer. The state of competition in the interstate long distance industry is quite tenuous. Almost all major facilities-based carriers are losing money and no competitor of AT&T is earning anywhere close to its cost of capital. In this context, if AT&T is given the freedom to price its services any way it wishes, this nation's telecommunications users will inevitably be denied the benefits from the AT&T divestiture which they were promised.

AT&T's ability to underline competition through "flexible pricing" stems from two basic sources. First, it is the only entity which possesses the information necessary to effectively design "optional calling plans" such as Pro America. This unique ability to design effective rate plans to serve only the most lucrative segments of the market stems from AT&T's ability to graner data on virtually every telephone subscriber in the nation. This capacity derives from its prior status as the nation's monopoly provider of services. The OCCs, on the other hand, do not have access to such information.

Second, while in a truly competitive market it can be argued that it is not in one's self-interest to price below cost, the long-distance industry is not yet such a market. Any losses that AT&T incurs are recoverable in areas where AT&T retains a monopoly position (e.g., 800 service).

Question. About what percent of the market do you have now?

Answer. GTE Sprint has approximately three percent of the interstate interexchange market, while AT&T retains approximately 90 percent. AT&T's market share has been the source of controversy because it has tried to mask the imbalance by expanding the market definition. By focusing on all interexchange traffic, including intrastate and intraLATA calling, AT&T claims a market share of only 65%. This view is extremely misleading, however, because intraLATA service is virtually a BOC monopoly; neither AT&T nor the OCCs are significant competitors in intraLATA services. As a result, it is not appropriate to include such traffic in measuring the current state of competition.

While some have pointed to the OCC's growth rate as an indication of success and a competitive market, those statistics also can be misleading. While it is true that the OCCs have increased the number of subscribers they serve, the fact that a consumer becomes an OCC subscriber does not mean that it uses the OCC to any significant extent, if at all. Numerous companies have arrangements with a number of long distance providers, both OCCs and AT&T. It means almost nothing to say that any OCC or group of OCCs serves 400 of the Fortune 500, as is often done. Under this approach the total number of subscribers credited to all carriers will greatly exceed the universe.

In addition, growth does not in and of itself indicate profitability. Such is the case with GTE Sprint. While it is true that the number of consumers subscribing to OCCs has increased, nevertheless no major OCC is earning a return anywhere close to its cost of capital.

Question. Under the current plan, the OCCs will pay more for their local connections as telephone companies improve the quality of exchange access. GTE Sprint and three other OCCs have asked the FCC to change its equal access transition plan. Aren't you asking for a change of the rules in the middle of the transition?

Answer. The OCCs are not urging the FCC to change its rules in the middle of the transition. Rather, it is the FCC which has changed the rules in the midst of the process. GTE Sprint is requesting that the Commission return to its original approach to the transition to a competitive environment.

In 1983, the FCC recognized that it was necessary to evaluate the competitive effect of differing access arrangements if competition was to develop. The Commission found this analysis to be important because, without it, the development of competition and network efficiency could be hindered.

Unfortunately, when an additional form of access became available to the OCCs, the FCC simply assumed, without any foundation to support it, that it was equal in all respects to the interconnections offered to AT&T. The economic condition of AT&T's competitors makes it clear that the Agency erred in not following its own precedent. The greater connectivity, the access to specialized services, the more convenient form of service and the freedom from conversion costs which AT&T and its subscribers receive through premium interconnections have significant value over and above that service provided to the OCCs. This difference, heightened during the transition period, is undermining the potential development of competition.

Question. Is your argument that "equal access" is not really equal grounded on specific, technical flaws with the connections you receive or some more nebulous theory that AT&T is still big and still has some historic advantages?

Answer. Many of the problems that the OCCs are facing have been detailed in an OCC petition requesting the FCC to reevaluate its plan for moving the industry from a monopoly model to a competitive one. These inequalities include the following: (1) the conversion process requires the OCCs to incur many costs and endure many inconveniences that AT&T does not face; (2) during the phase-in period, even areas with equal access will experience lower quality service on calls placed to or from locations still not converted; (3) about 20 percent of the BOC's access lines are exempted from conversion to equal access indefinitely; and (4) the "equal access" process will not give the OCCs the ability to provide 800 Service, 900 Service or coin seat paid calling.

With the exception of AT&T, the industry comments on that petition manifest a general agreement that the OCCs are facing *real* problems. These problems are not theoretical and not simply premised on AT&T's size and significant advantages stemming from its prior monopoly status. Much of the problem is created by government policies which allow AT&T to enjoy even greater artificial advantages and permit it to utilize these advantages in a manner which undermines the possible development of a competitive industry.

Question. Will you serve rural residents?

Answer. GTE Sprint and other OCCs definitely intend to serve rural subscribers. OCCs currently are building networks that will have the capability of serving all parts of the country and applying for certification in states both for interLATA and intraLATA authority. It must be remembered, however, that AT&T as a regulated monopoly took over 50 years to build its network. The OCC industry cannot be expected to accomplish the same feat overnight. That is not to say that herculean efforts are not being made. For example, last year Sprint network construction costs exceeded \$1 billion. Absent the proper regulatory environment on both the federal and state level, however, some parts of the nation may never receive the full benefits of competition.

Rural subscribers must be very concerned about the development of nationwide, facilities-based competition. If the proper policies are not in place a danger exists

that competition, if it survives at all, will provide consumer alternatives only in major metropolitan areas. The national carriers in such an environment inevitably will have rates that will be lower on the high density routes and higher on the low density routes, a situation obviously detrimental to rural subscribers. This will be done, even if a policy of nation-wide averaging is in place, by means of optional calling plans.

The CHAIRMAN. Thank you, gentlemen.

Senator Hollings.

Senator HOLLINGS. I apologize for being off for that vote.

I would ask our friend Mr. Brown, with respect to the cost of services of AT&T, following up the comment by Mr. Brophy about a review of the entire situation, what is reasonable and what is the real cost, and are we paying more or should we pay less? I would think I would have to background that against the general, overall cost of service schedule of the American Telephone & Telegraph Co., and you and I were talking about the difficulty, and I know how the allocations can be made in either direction. And still, with that difficulty, we were going to try to work on it and we were going to have the cost of services scheduled.

Do we have that schedule of the cost of services? Suppose I was appointed tomorrow morning to the FCC and we had a case involving the three of you and all three are complaining one way or the other, and so I go back to the staff and I say, well, give me the general overall cost and find out what the adjustment is and who is right and who is wrong, or generally speaking there are going to be some disputed areas about offloading this particular cost which somebody could argue, and oh, that should have gone long distance; no, it should go to the local. I understand those arguments, but I have got to have a general feel. As they say in Alice in Wonderland's character, before we can determine where we are headed, we must first determine where we are.

I want to know where I am.

Can you tell me?

Mr. BROWN. Well, let me point out that although there are cost disputes, as Chairman Fowler said, it is very clear how costs are determined and how they are to be reported to the FCC. There is a very large cost manual which does this, and depending upon the nature of the size or the importance of the filing, we file huge amounts of data to support that filing based specifically on what it is the FCC asks for in the way of backup data.

I do not think there are very many arguments about whether or not the data fit what the requirements are of the FCC. There may be arguments about whether those requirements are appropriate, because there are a good many theories on how to price. The FCC does carefully look at the backup material which they ask for and which we supply for every filing that we make, and they take a time to do this. In the last filing of which these gentlemen complained, reach out America, it took 103 days between the time we filed it and the time we were permitted to set up a trial.

A good many States have accepted on our cost data on reach out America. It is by no means predatory, and this has been agreed to by nearly every commission which has decided it. So it is necessary, it seems to me, to realize that we have complied with the rulings of the FCC and the State commissions in what cost data we

provide, and we are not, as the gentleman would suggest, getting away with some predatory scheme.

Now, they, of course, are not required to file any cost data, so if there is anything predatory going on, we might look around here.

Senator HOLLINGS. Very good.

Let me ask, Mr. Brown, I did not have the opportunity to hear all of your testimony. In that regard, and I do not mean to be blunt, but are you here complaining or are you here defending yourself? What is your message to the Commerce Committee here this afternoon?

Mr. BROWN. I can express my feelings, my message, if you will, in a very simple phrase. First of all, as I have said for many years to you and to many others, this whole idea of divestiture was not my idea. You will not find AT&T coming in here to complain about IBM, which has an equipment manufacturer in the telephone business, which has a piece of MCI and which dominates the world in computers, and asking that restrictions be put on IBM. Despite the fact that we are starting against IBM from scratch, we are willing to go ahead and take the marketplace beating and go ahead and pound away as competition is intended to do.

Our feeling, our message is that the customer is getting abused by the current situation and the way for him to get the advantages of competition is to let the competitors compete. We are not asking for streamlined and equal regulation. There has been no deregulation in the first place. We are asking for a reasonable price flexibility. We are willing to defend our prices against any standard, but we are against the idea of going through the same sort of labyrinth that we have been going through for the last 100 years to justify tariffs when our competitors have no such requirement. It merely delays what we are trying to do to provide lower prices to the customers.

Senator HOLLINGS. Very good.

And Mr. McGowan, what is your message or what would you have this committee do?

Mr. MCGOWAN. My message to the committee would be for the committee—in its proper role as overseer of the Federal Communications Commission—to ask the FCC to investigate, in a detailed hearing process, an investigative process of the reality of what is taking place insofar as it affects the economics of the competitors. We support very strongly the petition filed by GTE at the FCC that the Commission is dismissing out of hand the possibility that what it has structured, is a situation where the economics are so harmful to the competitors that you are not going to end up with a truly competitive industry.

We think there are enough facts. You are looking now at three people who represent probably, and I would guess, 99 percent of the assets in this industry. The FCC blithely counts, we heard before, if you were here, Senator, they said 200 carriers, competitive carriers. I do not think Mr. Fowler smokes, so it could not have been that.

This is a myth; all except we three and a tiny little bit else buy their communication capacity—principally from AT&T, some from us, some from Sprint—and resell it. These people are going out of business every day, 10 or 20 a week. They just do not exist any

more. There is no one out there spending money. When you find an industry going competitive and opportunities arise, you have typically found, what you found in trucking, what you found in airlines, are companies coming into that business because they are attracted by the economics of it. You do not find anybody now coming into this market. You find people in this market going out of business.

And the number, I believe, was about 400—that was the best guess about 6 or 9 months ago of how many people counting resellers were offering long distance service, even though most of them were using other people's lines. And now we do not find 50 of them out there.

But the point I am making is that when you ask "who is investing money," it is only the people basically at this table.

Senator HOLLINGS. Would you mind filing your costs? If I hear correctly that you do not when you make your application before the FCC, have to file the costs.

Would you mind filing those costs?

Mr. McGOWAN. I believe—I do not know whether we still do file cost support data. I think we do file cost support data, but we are not restricted as to our rate of return. In other words, the FCC does not impose upon us a specific rate of return, and therefore there is less regulation of us because we do not have a rate of return. In other words, we do not have a rate base, and so, therefore, there is far less regulation.

Senator HOLLINGS. Mr. Brown shook his head.

What were you going to say, Mr. Brown?

Mr. BROWN. Well, I think it is very clear that MCI does not file cost-based tariffs. They can put tariffs in 24 hours after they file them, and there is no way for the FCC to consider costs even if they are submitted.

Senator HOLLINGS. And excuse me, Mr. Brophy. Again I apologize, but your message, what would you have this committee do now?

Mr. BROPHY. I think first of all the committee has to realize that it is dealing with a unique situation. There is no parallel to a company that has had a 100-percent monopoly, not gained by its own competitive capabilities but by Government action. This is not the situation that Mr. Brown describes of IBM and AT&T competing. IBM does not have or never had a Government-created monopoly. And it has faced competition consistently. AT&T has achieved many benefits including one of the world's outstanding laboratories that it has gained as a monopoly, paid for through the rate of return, paid by the Nation's ratepayers. That is what is permitting it to compete with IBM at this particular point in time.

Now we have competitors coming in starting from scratch attempting to compete with this monopoly. I wonder when AT&T entered into the agreement to have a consent decree whether they really considered the fact that if there was going to be competition, that meant that there had to be healthy, and healthy in industry translates into profitable, competitors. If there are no profitable competitors, there cannot be effective competition.

The same time there is effective competition, it does have to mean that AT&T has to lose some market share because starting

out from 100 percent, there cannot be effective competition if it retains the market share it originally started with.

I think that all we ask in this hearing is that this committee use its oversight capabilities to urge the FCC to consider these very difficult issues of transition from monopoly to a competitive environment and make sure that the values that the OCC's have to pay for in interconnection are equivalent to the values that AT&T pays for, not just the cost of what is being provided.

Senator HOLLINGS. Well, is there some bill that you would have me introduce as a Senator, or is it the pressure of the oversight hearing to make certain that the FCC responds in a diligent fashion?

Mr. BROPHY. I would surely not recommend legislation at this time. I would hope that it would never be required. But I would think that if the FCC is not responsive, and I surely would hope and expect that it would be, that there might come a time when you will have to make the decision as to whether you want to see intercity service remonopolized or whether you want to take legislative action.

The CHAIRMAN. And at what stage are we now, would you say? When will I be seeing that perhaps happen one way or the other? Will we know by the end of the year? I just do not have any grasp of it. Another year or 2 years' time?

Mr. BROPHY. I think you will surely know over a 2-year period. As I said in my testimony, there is no OCC who is a facilities based carrier, that is a carrier who has invested in a large amount of facilities, who is earning a reasonable return on their investment or even close to their cost of capital at this particular point. That is a condition that cannot continue.

Mr. BROWN. I would say also AT&T is not earning its authorized rate of return or anywhere near it at this point.

Mr. BROPHY. We will trade.

Mr. BROWN. That is very generous. I know Mr. Brophy is sitting on a very large local telephone monopoly which, with his long-distance business, earned about the same amount as AT&T did in 1984.

Senator HOLLINGS. Now you are getting with the program. I am beginning to learn something.

We are very conscientious about it, and it is a mammoth thing, Mr. Brown, when you talk about starting from scratch. I think if I had AT&T's scratch, I would love to have that scratch to start with.

And yet at the time there is beginning to be some competition. You are letting 24,000 employees go to try to slim down and streamline and compete. So there is an effect being enjoyed or experienced, and I just want to make sure that we are doing our job. We do not want to meddle in.

Would you introduce any legislation, Mr. McGowan? Do you recommend any at this time?

Mr. MCGOWAN. No, no, Senator.

Senator HOLLINGS. Nor do you, Mr. Brown?

Mr. BROWN. No, sir, I do not think that is necessary.

Senator HOLLINGS. All right, that is one thing the three of you agree upon. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. We have another vote on the floor of the Senate, which is now halfway through.

We will have to stand in recess now, gentlemen. My hope was to finish up with you before the vote. I know I have a couple of questions, and maybe some other Senators do.

Senator HOLLINGS. Mr. Chairman, could I ask just one question before you recess?

My colleague Senator Gore says in your testimony, Mr. Brown, you seem to be threatening to abandon your commitment to serve all customers, especially rural customers, if things do not go your way.

Are you suggesting that you could foresee asking the FCC to abandon toll rate averaging?

That is from the Senator from Tennessee. Our colleague on the committee wanted that question asked of you.

Mr. BROWN. No, sir, it is not our intention to abandon customers or abandon averaging. The economics of the matter are, however, that if we are not able to compete in the heavy traffic areas and with the heavy usage customers, the economics of the matter will mean that we will be unable to continue low cost service for rural customers.

Senator HOLLINGS. I have some other questions I will submit for the record.

The CHAIRMAN. My hope is some Senator will be here in the very near future. If not, I will be here in about 10 minutes, so please do not go far.

We will stand in recess for however long it takes for somebody to be here.

[Brief recess.]

Senator GORTON [presiding]. First, I want to apologize to all three of you witnesses for the unavoidable way in which this hearing has been interrupted by rollcalls and to report to you with regret that there is no guarantee that it will not happen again, that we will not so again be interrupted, and also to apologize for not having heard most of your formal statements, though I have a general outline of the direction in which they went.

I believe that Senator Gore will have a few questions. I just have one or two at this point, the first of which would be directed to Mr. McGowan and to Mr. Brophy, and it would be is there any difference in your point of view as to what ought to be done either by the Congress or by the Federal Communications Commission?

Are you here with precisely the same message to us, or somewhat subtly or not so subtly different message?

Mr. MCGOWAN. I believe we come to the same conclusion. Yes, Senator, we believe that the FCC has not been diligent enough in examining the details of the process of going from a very small company such as both of ours were, and relatively speaking, not that big today, to become a viable competitor, in contrast to what AT&T who, after 100 years, at the moment of divestiture inherited a nationwide system to all sections of the country that had been put in place courtesy of the ratepayers of this country over the course of those years, and we believe the FCC is trying to be too simplistic about it.

We do not disagree with where they are headed. We believe that this industry, if we are viable, both Sprint and MCI, that that is where we should head—to deregulation. We think they are doing it too quickly, too simplistically, and without sufficiently understanding what the process is between here and there.

Senator GORTON. Mr. Brophy.

Mr. BROPHY. I think we agree on the nature of the problem. Mr. McGowan mentioned in his direct testimony that they support the petition we filed with the FCC seeking an examination of the transition process, and I am sure that an appropriate solution, if developed, will be supported by both of us.

Senator GORTON. Do the two of you agree on how long that transition process would be? Will you give us the same estimate of when it would be appropriate to have the same degree of deregulation for all companies?

Mr. BROPHY. We have not gotten together and talked about that in detail, although I would be reasonably sure that if we did explore it we would come out with a general agreement on it.

Mr. MCGOWAN. I believe that it is going to be defined by the marketplace when the customers of the United States, business and residential, generally have a choice of competitors and one does not have dominant size and control of the market. Then I think it can come about. I think that will probably come about gradually. It is not going to be, I do not think, an urban-rural issue. I think it will gradually get to the point where the FCC will be able to say, "we could start decreasing the amount of regulation," and we do not disagree with that. But it is certainly not here. It is certainly not going to be measured by a date such as September 1, 1986.

Senator GORTON. My ears perked up on that. I take it you do not think that we would be ripe for deregulation until sometime after AT&T's share of the market drops below 50 percent?

Mr. MCGOWAN. I do not think it is 50 percent, Senator. I do not want to quote Baxter, Assistant Attorney General Baxter, but he certainly gave the implication—at the time of the agreement that they had made with AT&T—the implication that it would not need to be that far, and it probably does not as far as the particular market share is concerned. But I think it is something that the FCC should follow, should study, should understand the positions today and gradually do it, and I think it is up to you to have oversight over that.

Senator GORTON. Mr. Brown, do you think that the interstate long-distance market is competitive right now?

Mr. BROWN. Yes, sir; I do not think there is any doubt. If you look at the appendix to my detailed testimony I pointed out that it is a rivalrous marketplace. I do not think there is any question but what it is competitive. If we are talking about market share, I think we ought to thrash out this difference in numbers. When I say 63 percent and Mr. Brophy rightfully points out it is all the way down from a very large number to 63 percent, the NTIA, the Commerce Department agrees with that number. I am talking about the long distance business for which people pay tolls. It is interstate, intrastate, and intra-LATA where there is a toll. It is 63 percent. It is down. It is low, and it has been dropping down.

So I do not think there is any doubt that there is competition. I think it is fairly clear what has happened to the market share.

Mr. BROPHY. Senator, I think we have to look at market share in terms of what is available to both of us and not the share of the market that we are precluded and they are precluded from competing in, the intra-LATA market.

Mr. BROWN. I have to disagree. We are not precluded by the MFJ from dealing in the intra-LATA market.

Senator GORTON. The chairman of the subcommittee is back now. I am delighted to see him, and I would defer to him, or if he is not ready, to Senator Gore.

Senator GORE. Thank you very much.

I, too, want to apologize for not being here when you made your opening statements, but as has been explained, we have had a series of votes on South Africa over on the floor of the Senate, and we may have one or two more. But I understand that Senator Hollings asked one question on my behalf to you, Mr. Brown, in reference to the statement in your testimony which seems to raise the threat of abandoning your commitment to serve all customers, particularly rural customers. And it is my understanding that in your response to Senator Hollings' question you left the door wide open for your company doing just that, abandoning your commitment to serve all customers, including rural customers.

Mr. BROWN. No, sir, I do not think I left the door wide open. You are a champion of rate averaging. That is where I come from through all of my telephone life. This has been AT&T's principle. I think we have done a good job. It has not been forced upon us by regulatory schemes. We are committed to serving everybody and committed to serving everybody at the same kind of price.

My point was, however, this is a competitive industry now. In the event that we are not permitted on a fair basis to compete for the lucrative, large city users and heavy routes, easy to serve, there is not going to be any money left to subsidize or to also handle the rural areas at the same kind of a price.

I am not threatening. I certainly am not threatening, because this has been a part of my being all along, and it is an important part of AT&T's future to be a ubiquitous carrier. All I am pointing out is that there is no free lunch in a competitive environment. All we ask for is a reasonable chance to compete on the lucrative routes.

Senator GORE. And if you do not get that, you may abandon rural areas?

Mr. BROWN. No, if we do not get that ability to compete, we may go broke.

Senator GORE. You would do that before you would abandon the rural areas?

Mr. BROWN. I do not really believe that abandoning the rural areas would make us rich. I am sure that it would not.

Senator GORE. I want to come back to this, but I welcome your comment, Mr. Brophy.

Mr. BROPHY. I think I should explain that the intercity carriers do not directly serve the rural areas. What we serve is the point of connection in the LATA, and the responsibility for serving or carrying that to the local and rural area is the obligation of the ex-

change carrier so that the obligation that AT&T had before it was broken up to take service to everybody's home or office, wherever it is located now has been divided between the local carrier, the exchange carrier, and the intercity carrier, and a great part of that burden rests on the exchange carrier, and it will be served. When the intercity carrier brings their service to the exchange carrier, the exchange carrier will take it the rest of the way.

Senator GORE. Well, this is the point we got to in the previous day's hearing, and I am given to believe it is a little more complicated than that.

Do you want to respond to that?

Mr. BROWN. Of course, what we are talking about, I believe what you are talking about is the person in Carthage TN, who wants to make a call. Mr. Brophy is talking about—

Senator GORE. You have got it.

Mr. BROWN. Mr. Brophy is talking about the one who wants to receive a call, and of course, Mr. Brophy and Mr. McGowan can get to Carthage by virtue of using AT&T and South Central Bell's facilities. We are now talking about the ability to make or originate calls, and what the cost is to the rural costomer. That is where these two fellows do not have any idea of serving.

Senator GORE. Well, what about it? What about that, Mr. McGowan.

Mr. BROPHY. We might speak for ourselves.

Mr. MCGOWAN. That is not true. MCI intends to cover every area of the country for originating and terminating. We terminate to every phone in the United States today. We, as of September 1, I will give you the numbers, we carry 96 percent of our traffic over our own system. Now, that means that there is 4 percent of the traffic that will use someone else.

Senator GORE. Is this for receive or originate?

Mr. MCGOWAN. I am talking about terminating.

Senator GORE. What about originating?

Mr. MCGOWAN. We cover in the United States now 135 of the 162 local areas. The United States is divided into 162 Bell local areas.

Senator GORE. Do you cover Carthage, TN?

Mr. MCGOWAN. We cover Nashville. That is the local area for Carthage.

Senator GORE. Can you originate?

Mr. MCGOWAN. If that switch wants to originate with us, it can. It has not elected to do so. You must remember—

Senator GORE. Wait a minute.

Mr. MCGOWAN. The local switch in Carthage.

Senator GORE. I did not know those switches had gotten so smart yet.

Who has to ask for it?

Mr. MCGOWAN. The local telephone company.

Senator GORE. Well, suppose I want to make a call over MCI? How do I do it?

Mr. MCGOWAN. All right. Every day there are approximately 10 or 20 new central offices that are converting to equal access in the country. We are up to 1,220 central offices in the United States. Supposedly by the end of this year, we heard a number, about 50 percent of all the telephones in the United States, and by Septem-

ber of next year, it is estimated that in the very high 70 percent of all of the phones.

Senator GORE. Well, can I interject there, under the MFJ, the Bell companies and GTE are required to provide you with equal access in exchanges larger than 10,000 customers or in any exchange where you request it, is that correct?

Mr. McGOWAN. Yes, that is correct. Where we technically can do it; yes.

Senator GORE. Ali right.

In how many instances have you requested equal access into exchanges of fewer than 10,000 customers?

Mr. McGOWAN. We have not requested anything specific right now. They are in the obligation period where they must make a certain number available to us.

Senator GORE. Zero in other words?

Mr. McGOWAN. That is right. We anticipate they will live up to the judge's—

Senator GORE. But you have not requested access into any of the smaller, defined as under 10,000 customer, markets, and you do not anticipate doing that any time soon, do you?

Mr. McGOWAN. Yes, we do. We anticipate that we will be able to originate traffic from any phone that is from any of the 162 areas, hopefully before the end of 1986.

Senator GORE. Can I pursue this just for a minute, Mr. Chairman?

Senator GOLDWATER [presiding]. You may.

Senator GORE. I will nevertheless try to get through this in a hurry.

We are missing somewhere, Mr. McGowan—I know you are one of the smartest people in the country on these issues, and I want you to explain it to me, and Mr. Brown, I want you to listen carefully and tell me if there is some aspect of it that I need to know in addition to what is presented.

My assumption is that because AT&T is under the obligation to average the rates, that they are going to be offering access to the low density areas at affordable rates whereas because you do not have the obligation to average rates, you are going to be forced by the structure of the marketplace to direct your attention and investment toward the high density areas, and you are not going to show much interest in directing attention and investment toward the rural areas, and the competition which results from your uneven entry into the marketplace will tend to drive rates down in the high density areas and may create a situation where AT&T has to or feels the pressure to give up this averaging in order to continue meeting your competitive challenge in the high density areas.

That competitive dynamic therefore works to the disadvantage of rural customers. On the positive side, the ability to choose between alternative companies is not likely to be available to them for a long time because you are not interested in getting to the low density areas, or because of the structure of the marketplace.

Now, tell me where you believe that image of the problem is wrong.

Mr. McGOWAN. All right, let me exempt from the problem a special situation so it does not confuse the issue.

There are a number of central office switches in the United States today that have been installed, and a number of them are in rural areas, although we found them in the middle of New York City as well, where the switch, because of the age of the switch, technology of the switch is such that it does not have the intelligence, it is not designed so it could, for example, allow someone to choose between a bunch of carriers and automatically the traffic would go to them. For example, it must accept only one long distance carrier, and that affects, the number is as high as 25 percent of the phones.

Now, that number goes back 3 years, and I am sure they are being changed out every day as these companies are changing from the old-fashioned switch to the modern ones. By the way, one of the motivations for it is not simply for equal access. Those older switches do not allow you to do a lot of things. They really do not offer the features of the new central office switch.

Now, if I take that problem and set it aside, the problem is not going to be our economic incentive. Where the problem is really coming from us doing it as quickly as we maybe would like to do it is that in the State environment, where you find a can of worms, the States themselves typically have so little desire to be involved in what is going on that whereas, for example, AT&T automatically was authorized as the inter-LATA carrier in every State where they were, we had to fight in each one of them. We still are not successful.

For example, there are only seven States where we are allowed to provide long distance service both intra-LATA and inter-LATA. There are 15 States where we do not have authority yet. And in then the balance of them, we are only providing inter-LATA.

Now, when you get to the intra-LATA situation, what the States are saying to us—and by the way, each one is doing it differently—it requires vast resources. I think Mr. Brophy and I are going to receive awards from the law association this year for what we are spending out there in trying to deal with all of the States. What they are saying is “we do not want you to build around this LATA, and therefore, to the rural areas. We are not going to authorize you to provide the service.”

Now, we do not have any possibility, therefore, to ever justify constructing to a lot of those areas because the States are saying “we will not let you provide long distance service,” which means the only thing we could provide when we arrive in that, let's say, smaller community, is going to be interstate. And typically, the amount of traffic is twice as much intrastate as it is interstate. And so the States are the ones that are saying “we do not want you there.”

A lot of the independent telephone companies that represent the rural area are fighting us every step of the way.

Senator GORE. If you will forgive me, I would like to interrupt you there. I hear what you are saying, and I understand it, and it is very interesting, but it does not address the central conflict between AT&T's way of serving the whole country and your freedom to pick and choose.

These other problems I am certain are very significant, the nature of the technology, the switch, the nature of the State au-

thority, attitudes, and so forth, but I am trying to get at the basic economic question.

Now, you make more money serving high density areas than you do low density areas, right?

Mr. McGOWAN. Both of us—AT&T and MCI—only serve from a hub in any one area of the country. The traffic comes into our hub. You can think of us as an airport because that is what we have, a big toll switch just like AT&T does.

Now, the local phone company gets paid to bring that traffic to our toll switch. AT&T pays them, we will pay them. Typically, when you get to the toll switch, Both of us provide service on high capacity systems.

Senator GORE. But in my house you cannot get into MCI.

Mr. McGOWAN. You are in the Nashville LATA, and that switch is capable of doing it, if they are willing to convert, you will be able to get a choice between us because the local phone company—

Senator GORE. Well, you have got to ask to serve Carthage. It is 50 miles from Nashville. I mean, these LATA's are very big.

Mr. McGOWAN. There are some LATA's that are an entire State.

Senator GORE. That is correct, and in order to originate within a rural area within a LATA, some of which you serve, involves a lot, and if you have got the economic incentive to focus your investment and energy and marketing plan on the high density areas, that is what you are going to do.

Mr. McGOWAN. But I do not need to spend any money to go those 50 miles.

Senator GORE. To originate there?

Mr. McGOWAN. That is right, to originate there. Within the LATA, they have agreed, and get paid for it, to transport traffic as well as give an equal choice. They will transport it to our point of presence as it is called.

Senator GORE. OK.

I need more time than I can gracefully request from the subcommittee. I would ask the indulgence of the subcommittee to let Mr. Brown respond to this and Mr. Brophy, I am not ignoring you.

Mr. BROPHY. Could we provide you with a paper on this subject?

Senator GORE. If you would, I would read it very carefully, and if you could briefly respond to this, Mr. Brown?

Mr. BROWN. Well, I guess the first thing to say is there are two things involved here. One is the access from small towns which Mr. McGowan has just been addressing. I think everyone knows at the present, at least, whatever their future intentions are, the small towns and rural areas are not being served by the OCC's.

Second is the rates paid. The rates are already deaveraged by the other common carriers, and that is the other question that you were raising. I think you have the right questions, and I would enjoy seeing the answers these gentlemen submit.

Senator GORE. Would your rates not be significantly higher for the low density areas without an averaging requirement, Mr. McGowan?

Mr. McGOWAN. No, they would not. They could be, because the local phone company might very well say that "for me to transport them, we want another charge," that is, to access into the long distance network. But, if you look at AT&T's owned and operated net-

work, except for its size, you are not going to find it very much different from MCI's.

Senator GORE. I will pursue this matter with you on my own time.

Thank you, Mr. Chairman.

Senator GOLDWATER. Mr. Chairman.

The CHAIRMAN. Mr. Brophy, is it your testimony that if AT&T is permitted flexible pricing in the near future your company is threatened with what, going under?

Mr. BROPHY. I think it creates a very serious problem for us and threatens the health of Sprint. Clearly AT&T has the economic power to, through adjustments in rates, target those areas in which they believe the OCC's have an opportunity. Reach Out America, Pro America are examples of that. If that happens and the OCC's growth is stifled, or if in fact they begin to lose market share—and in our case we only have 3 percent of the market at this particular point—the chance of ever having healthy competition I think is eliminated.

The CHAIRMAN. Do you think your company's survival would be threatened?

Mr. BROPHY. I think Sprints could be.

The CHAIRMAN. Mr. McGowan, do you think that MCI, would its survival be threatened by pricing flexibility?

Mr. MCGOWAN. That would obviously depend upon what they were. But those in front of us—I do not believe our survival is being threatened. We are profitable today.

The CHAIRMAN. You do not believe your survival is threatened?

Mr. MCGOWAN. No, I do not believe so.

The CHAIRMAN. So whether or not they are granted pricing flexibility you think you will survive?

Mr. MCGOWAN. I believe we will survive, yes.

The CHAIRMAN. Do you have a judgment as to your smaller OCC's?

Mr. MCGOWAN. I think for most of the OCC's who are just beginning to start, build and operate their own facilities, it may already be too late for them. Some of them may have a chance; but, basically, by the FCC's ruling 2 years ago, with a substantial increase in what we pay for the kind of access we were then getting, basically hurt them and their margins so much that I think they lost the confidence of the financial community. The capital dried up for them, which is, after all, the key essential ingredient which the FCC apparently ignores—any kind of measure of capital markets—and therefore they were not able to raise the capital. Therefore they could not build their systems. So therefore they are at the mercy of somebody else's tariffs.

So I do not know how many of them will survive. Certainly if there is more pricing flexibility given, and AT&T does use it, then I would opine that I do not think any of them will survive.

The CHAIRMAN. Mr. Brown, do you think that the FCC should factor in the survivability of the OCC's in determining the timing of granting AT&T pricing flexibility?

Mr. BROWN. Well, I guess I would first dispute the premise that if AT&T had pricing flexibility, it would drive anybody out of business.

The CHAIRMAN. I am just saying hypothetically, if they were to make that factual finding, do you think that should affect their judgment, or do you think that you should be granted rapid pricing flexibility regardless of that consideration?

Mr. BROWN. Well, as Mr. McGowan says, I believe that the strong carriers, the well managed carriers, the ones who innovate, will survive all right. I think the ones who have been——

The CHAIRMAN. Let's just suppose hypothetically that the experts at the FCC were to determine that the OCC's would be threatened by pricing flexibility.

Do you think that that should be the basis of their decision on pricing flexibility, or do you think you should be able to have pricing flexibility regardless of that consideration?

Mr. BROWN. I think if the consideration was whether or not competition was going to be entirely wiped out by pricing flexibility, then they would really have to consider that because the policy is surely to have competition in this country. If the question, however, is whether all carriers should survive, I do not believe such a cartelizing of the market is what this country has in mind.

Mr. BROPHY. I agree with Mr. Brown on that.

The CHAIRMAN. Now, just one other question for each of you.

Were you heartened or disheartened by what you heard from the FCC today?

Mr. Brophy.

Mr. BROPHY. I guess I await the proof of the pudding.

The CHAIRMAN. From what you heard today, were you heartened or disheartened?

Mr. BROPHY. I heard some things that encouraged me. The FCC indicated that they would look at the matter thoughtfully and promptly, and if they do that, I have reason to be heartened.

The CHAIRMAN. Mr. McGowan.

Mr. MCGOWAN. I am discouraged, and it is because I do not think—they do not know what they do not know, and if you are in the missile business, it is called an unk-unk, and that is the worst thing you can have, because you have a problem, but you do not know you have a problem. And I do not think they understand (a) capital formation. I do not think they understand (b) meeting (a) payroll. I do not think they understand (c) the marketplace. I do not think they understand (d) marketing, customer service. I do not think they understand the process, and therefore they are operating on fairly simplistic, jingoistic type words and ideas, and therefore, I do not think they have the ability to perceive what they do, the implications of that, and therefore, that worries me that they cannot therefore perceive the importance, for example, of studying what people have asked them to study.

The CHAIRMAN. Mr. Brown, when you leave the committee room in another minute or so, will it be with a new spring in your step or will you be downheartened?

Mr. BROWN. I try to keep the spring in my step despite what has happened to my business over the last few years.

I believe the FCC is carefully considering the things they have in front of them. I believe they are acting cautiously and to my point of view far too slowly with respect to doing what they must do, which is to get out of the way of competition.

The CHAIRMAN. Thank you, Mr. Chairman.

Senator GOLDWATER. I just have a couple of questions here.

Mr. Brown, a number of your competitors contend that you have a total or near monopoly power in certain service markets, like 800 service, coin telephones, and most international routes of traffic. Your competitors argue that these services provide you with funds for cross-subsidizing competitive services.

What is your response to these arguments?

Mr. BROWN. This has been a concern of the FCC for many years, and especially since the competitive environment has been introduced, and it is one of the reasons for the vast cost information which we supply to them.

I just cannot believe that with the cost information they have and with the information that they have had over the years and with the experience of the FCC in analyzing it that any cross-subsidy exists at all today.

Senator GOLDWATER. Mr. McGowan, four OCC's filed a petition with the FCC asking it to amend its equal access transition plan.

Does the fact that you did not join in the petition mean that you think the transition to equal access is going smoothly?

Mr. MCGOWAN. No, we are supporting that petition. We were directing our efforts at that particular moment to work with the Department of Justice, and I did not want the Department of Justice to think that the FCC was going to handle it because I did not have as much confidence in them that they would.

My prediction is kind of being borne out. We are getting much more responsiveness on the problems of equal access from the Department of Justice. I must give the FCC credit though, certainly, that they did study and did come up with a decision about allocation of traffic so that that was properly allocated, but as far as the petition by GTE and other companies, we have supported that, but so far we have not seen any indication that the FCC is going to conduct the kind of studies that we think are necessary.

Senator GOLDWATER. Thank you.

Mr. Brophy, one question for you.

You seem to be asking the FCC to define equal access according to value as well as technical quality. How can the FCC quantify value?

Mr. BROPHY. Well, FCC did look at value in originally establishing the differential for the unequal access that was established, the unequal technical access, and I think they can look at value in determining the charge, the appropriate charge that should be made for what is approaching a technical equal access. I think they can look at the elements that are involved, the fact that the OCC's have to incur additional expense to take advantage of it that AT&T does not have to incur, the fact that the OCC's are saddled with a marketing problem that AT&T is not faced with because of the methodology of converting on an exchange by exchange basis.

I have outlined in my written testimony the number of economic problems and value problems that the OCC's face that AT&T does not face, and I think an examination of those and some intelligent thought can result in an appropriate valuation.

Senator GOLDWATER. I might ask all of you, because we are constantly asked this question, can you describe any legislative ap-

proach to solving this problem or problems, any of you or all of you?

Mr. BROPHY. I personally do not believe now is the time to propose legislation, and in the unlikely event that we ever reach that point, we will come forward with a proposal, and I would hope that we would never reach that point because I think at that point the public—and I think it is the public that we are really interested in here—that the public is at the risk of not being served as a result of the failure of the competitive effort.

Mr. MCGOWAN. I believe, Mr. Chairman, that because of the status we are finding ourselves in in this industry, in a fluid nature going through this process, and with changes coming about, becoming aware of things, I think the FCC is the one that you people have designated to be, to supervise this. I think instead of legislation, what we hope is your oversight of the FCC to insist that they are doing the kind of things that you believe are necessary for them to make the proper value judgments about the process, oversight rather than legislation.

Mr. BROWN. I agree with that, that there is no need for legislation at this time.

Senator GOLDWATER. Thank you very much, gentlemen. You have been very important witnesses, and I think the whole industry and the public will benefit by your testimony.

I want to on behalf of the committee thank you for coming.

Our next witness will be Dr. Lee Selwyn, president, Economics and Technology, Inc., Ad Hoc Telecommunications Users Committee.

Dr. Selwyn.

STATEMENT OF DR. LEE L. SELWYN, PRESIDENT, ECONOMICS AND TECHNOLOGY, INC., ON BEHALF OF THE AD HOC TELECOMMUNICATIONS USERS COMMITTEE, ACCOMPANIED BY JAMES S. BLASZAC, COUNSEL

Mr. SELWYN. Thank you, Mr. Chairman.

Mr. Chairman, I serve as economic adviser to the Ad Hoc Telecommunications Users Committee. To my left is Mr. James Blaszac, who serves as counsel to the committee.

The committee appreciates the opportunity to appear before you this afternoon and to express our views on the issues that I think we all agree are of utmost importance to the development of a competitive telecommunications industry in the United States. The ad hoc committee has long supported and favored competition in the U.S. telecommunications industry and has advocated policies aimed at the achievement of an effectively competitive telecommunications marketplace.

As major corporate users, members of the committee would in fact be among the early beneficiaries of an effectively competitive marketplace. The ad hoc committee has supported efforts by the dominant carriers, AT&T in particular, to introduce new and innovative services, services such as Megacom, SDN, and Pro America as competitive responses and innovations in this field.

But the ad hoc committee has become concerned that the development of competition in the market may have resulted not from

fundamental economic cost conditions but in fact from the various differentials in access charges and other regulatory policies that have existed up to this time that have been discussed extensively this afternoon.

Research which the ad hoc committee has done has indicated that, to a very substantial degree, the extent to which the newer firms have obtained market share in the intercity market has resulted in very large part from the availability to these firms of discounted access services and other benefits that are in the process of being eliminated. As a result, we feel it is difficult to conclude at this point in time that we are confronted with an effectively competitive marketplace in the absence of these regulatory differentials that have existed up until now.

Because of that, the committee is concerned that if the regulatory process is dismantled prior to the development of an effectively competitive marketplace, customers of all sizes, large and small, will be in effect left unprotected from the possibility of excessive prices. They will neither have the protection of economic regulation nor of effective competition.

In a number of filings that the committee has made with the Federal Communications Commission, we have urged the Commission to first gather hard information, hard data on the economic structure of the industry so that it can satisfy itself that effective competition will and can develop in this market once the access cost differentials and other non-cost-based distortions are eliminated. We have urged the Commission not to dismantle the regulatory process until it has been able to affirmatively satisfy itself that competition is viable in the long run, and finally, we have urged the Commission to mesh the development of policies leading toward deregulation of the dominant carriers with the development of effective competition in the marketplace so that as competition replaced economic regulation, then and only then would economic regulation be reduced and ultimately eliminated.

We believe that this type of policy will ensure the most effective means of providing services at the lowest possible price and in the most efficient manner to the general public, to all users, large and small, and that it will lead to the maximum development of an effectively competitive marketplace to the extent that the conditions in the industry will permit that to occur.

I have submitted a written statement, and I would be happy to respond to any questions that the committee may have.

Thank you.

Senator GOLDWATER. Thank you very much. We will put your whole statement in the record.

Do you have any questions?

The CHAIRMAN. I do not, Mr. Chairman.

Senator GOLDWATER. Just a couple.

Do you think it would be foolhardy for the FCC to begin a transition to deregulation without first developing a comprehensive plan for transition?

Mr. SELWYN. I think the FCC should develop a comprehensive plan for transition to deregulation that, as I indicated, would be based upon hard economic data that supports the policies leading to deregulation, that the plan should be related to the development

of effective competition in the marketplace, and that incidental or piecemeal deregulation without a firm and established plan would not serve any useful purpose.

Senator GOLDWATER. Could it do damage?

Mr. SELWYN. Yes; I think it would, Senator Goldwater. It would run the risk I think of possibly leading to conditions where markets would be deregulated prior to becoming effectively competitive, which would not only frustrate the development of further competition but could also lead to excessive prices.

Senator GOLDWATER. Thank you.

You have testified that the market shares of AT&T competitors, the OCC's, have been stagnant and that few if any firms have entered the market since the transition to equal access began.

Why do you think this has happened?

Mr. SELWYN. Well, the transition to equal access has resulted in a very substantial increase in the OCCs' cost of doing business. To a very large extent, the basis upon which the OCC's have been able to compete in the marketplace has been their ability to price their services below the prices charged by the dominant carriers. That ability in turn has arisen largely and in fact almost entirely because of the lower access cost, access prices that the OCC's paid. As the price of access increases and approaches that paid by the dominant carriers, then the OCCs' ability to compete in this marketplace under the present market conditions and present cost conditions would be severely limited. As a result, the attractiveness of the market is reduced.

In effect, the OCC's, resellers and other newer carriers have been trading to a very large extent, their competitive entry has been driven to a very large extent by the access discounts. As these go away, the economics of the business undergo a fairly fundamental change.

I attached a diagram, Senator, to my prepared statement that highlights—it is on the last page—that highlights the access component of the total price that is charged by the various carriers, and I think that it serves to demonstrate the magnitude and importance of the access component in the OCC's ability to set their prices below those of AT&T.

As access charges become equal, the OCC's would be forced to either increase their prices, if they wanted to maintain the same net level of revenue, net of access charges, or would be forced to accept a lower net revenue level in order to maintain some price differential.

Senator GOLDWATER. Of course, one of the big arguments about the disenfranchisement and going along with deregulation is the fact that the competition would bring the price to the user down, and that has not happened. That is a major complaint that we in the Congress hear, and the prices in some cases, for example, my own home, have gone up five times.

Now, do you think there is any validity to the argument that the OCC's can eventually bring prices down without some major change in AT&T?

Mr. SELWYN. Let me first respond, Senator, to the question you raised about prices going up. There is no question but that there has been an increase in the level of prices in the telecommunica-

tions industry, and that many observers have attributed that to the development of competition. I take a slightly different view. There certainly is a connection between the development of competition and the increases in the level of local rates and other rates generally. But the connection is not necessarily caused by competition itself. Many local telephone companies have used the threat of competitive entry as a basis for justifying or for seeking to justify policies that have the effect of increasing their overall investment base and their ongoing operating costs. For example, they have used the potential for competition to justify new and massive construction programs, higher depreciation rates, and even the additional costs associated with converting older central offices and other older generation facilities to a more technologically current state, so that, although one could in a technical sense attribute some of these cost increases to the development of competition, I think that it is a somewhat indirect attribution.

Whether or not when we get to an equal access environment and an equal access price environment the competing carriers will be able to bring enough effective competition into the marketplace to offset some of these increases remains to be seen, and this is one of the reasons that the ad hoc committee has repeatedly asked that the FCC conduct studies and gather the economic data on the cost structure of this industry so that these kinds of questions can be answered.

Senator GOLDWATER. I thank you very much. Your testimony has been most helpful. As I say, we will put your entire testimony in the record, and I want to thank you on behalf of the committee for taking the time to come before us.

Thank you very much.

Mr. SELWYN. Thank you.

[The statement follows:]

STATEMENT OF DR. LEE L. SELWYN, PRESIDENT, ECONOMICS AND TECHNOLOGY, INC.

The Ad Hoc Telecommunications Users Committee appreciates the opportunity to present its views on the subject of long run regulatory policy and interim access charges and other tariff policies during the transition to an equal access, potentially competitive telecommunications industry environment. The Ad Hoc Committee has long encouraged and supported the development of economically sound and efficient competition in the intercity services market and the various FCC actions that have moved the industry in this direction. As some of the largest users of telecommunications services in the U.S., the Committee's members would, indeed, expect to be among the earliest beneficiaries of an effectively competitive marketplace. The Committee has, however, become increasingly concerned that the pace of development of competition in the intercity telecommunications industry has been slower than had been previously expected. The Committee has become concerned that the limited competition that does exist could be driven primarily by a number of pecuniary pricing distortions caused by regulatory policies.

As these distortions are corrected and ultimately eliminated through changes in regulatory policy, competition, if it is to survive and prosper, will have to be sustained by a solid economic basis. Policies leading to the ultimate elimination of traditional economic regulation of telecommunications common carriers should not be implemented without a firm demonstration that a solid economic basis for effective competition in this market exists.

THE AD HOC COMMITTEE'S FILINGS IN FCC COMMON CARRIER DOCKET NO. 83-1147

In a series of filings before the FCC in CC Docket No. 83-1147 in 1984, the Ad Hoc Committee expressed these concerns and, in particular, underscored the importance of obtaining hard data on the underlying conditions of costs and supply so that the

Commission could make policy judgments based upon an accurate understanding of the real and pecuniary forces that have driven and that will continue to drive competition in this marketplace. The Committee noted that, although the prices charged by most of the start-up firms were lower than those charged by the dominant carriers, the former were subject to a substantially lower level of access charges than were the established carriers, and that when access charges are excluded from the gross price of the various carriers' services, the dominant carriers' price (net of access charges paid to local exchange carriers) were actually lower than those charged by the new competitors (see Figure 1). The smaller firms have used the access charge discounts in part to enable them to offer their services at lower prices than those charged by the dominant firms and in part to offset their higher costs and generate profit.

As part of the transition to "equal access" mandated by the Modification of Final Judgment (MFJ), a substantial majority of central offices will be equipped for "equal access" for Other Common Carriers (OCCs) by about September 1986; under the FCC's access charge plan adopted May 10, 1984, the access charge discounts available to the OCCs are eliminated on a per-central office basis as each central office is equipped for equal access service. Thus, by this time next year, the OCCs' access discounts will have been substantially eroded, and their ability to offer services at rates consequentially different from those charged by the dominant carriers will be largely foreclosed unless the smaller firms are able to product their services at costs which are at or below those being experienced by the dominant carriers.

While some have argued that economies of scale are not present in the long distance services market, the FCC has never made such a finding, and indeed there is evidence to suggest that such size-dependent cost conditions are pervasive and substantial. If they are, the Committee is concerned that the dominant carrier enjoying this economic advantage could exercise considerable market power which, if not checked by continued economic regulation, could largely foreclose the possibility of such scale economies being passed on to customers. Stated differently, such a carrier, operating in a non-regulated marketplace, would have no incentive to set its prices more than slightly below those of its higher-cost, smaller competitors.

In its filings with the FCC, the Committee expressed the concern that conclusions as to the competitive potential for the intercity telecommunications marketplace were being formulated on the basis of past competitive growth under conditions that were decidedly not representative of those which will exist in the forthcoming post-equal access era. The Committee recommended that the FCC undertake to obtain hard data on the underlying conditions of supply characteristic both of dominant and non-dominant firms and that it formulate long run regulatory policy on the basis of prospective, rather than retrospective industry conditions. To the best of the Committee's knowledge, while the FCC has initiated a proceeding to develop long run regulatory policies to apply to dominant carriers, the Commission has not obtained or analyzed such hard data or otherwise considered its implications for long run policy development.

The existing economic regulatory structure should be retained until an effectively competitive telecommunications transmission services market has developed.

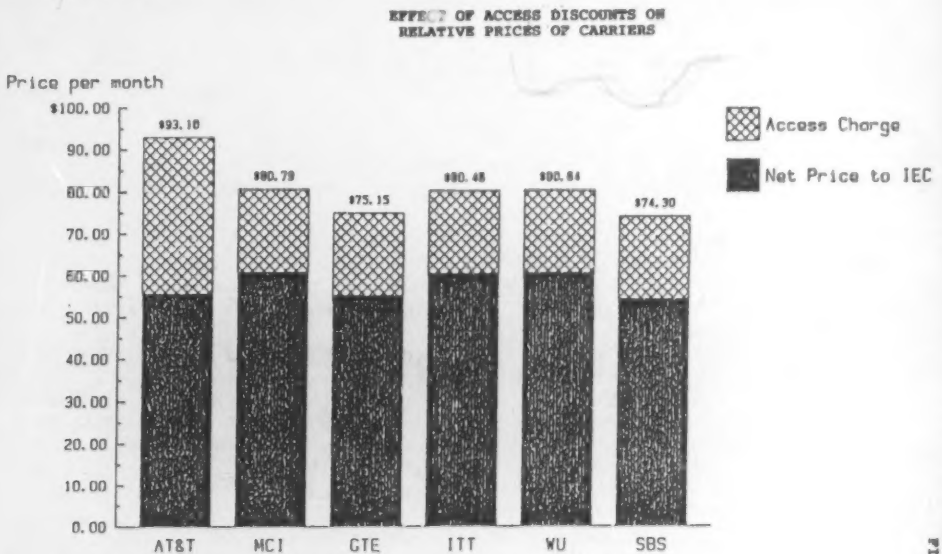
The Committee believes that, until such time as it can be affirmatively demonstrated that the underlying conditions of supply are conducive to the development of an effectively competitive marketplace in which the protections afforded by economic regulation can be replaced by competitive marketplace forces, it would be a serious and irreparable error to dismantle the existing mechanisms of economic regulation; indeed, as the Committee noted in its Comments to the FCC, the costs and risks of prematurely eliminating economic regulation in the absence of an effectively competitive marketplace far outweigh the considerably smaller costs and risks of maintaining economic regulation while effective competition is developing, if indeed that does occur. In particular recent and expected actions by the FCC to reduce and eliminate certain aspects of structural regulation of the dominant transmission carriers actually elevate the importance of continued economic regulation. The Committee believes that the dominant carriers should be permitted to introduce new and innovative services and service packages, provided that these are not cross-subsidized by other services over which the dominant firms exercise substantial market power. Continuation of economic regulation of the dominant carriers is critical to assuring this outcome, and can substantially reduce the risks inherent in structural deregulation, while making the advantages of the latter available to the public. Elimination of both economic and structural regulation in the absence of effective competition in the intercity transmission services market would retard—indeed possibly prevent—the entry of new competitors and the development of an effectively competitive industry.

Experience over the first year of the transition to equal access confirms the Ad Hoc Committee's prior concerns about the development of effective competition in the telecommunications transmission services market.

The Committee's concerns about the level of competition continue to be raised by general industry conditions and several specific events that have occurred in the initial year of partial equal access. OCC market shares, which had been experiencing steady growth in the period immediately preceding the introduction of the equal access transition plan, have remained largely stagnant. Entry of new firms had been almost non-existent, and a number of non-facilities-based resellers have existed in the marketplace. The Committee suspects that at the present time all the non-dominant facilities-based carriers are experiencing negative operating income, and that some seem to have severe cash flow problems. IBM has effectively existed in the intercity market by its merger of Satellite Business Systems (SBS) into MCI, a transition that, among other things, involved substantial write-offs by IBM. Price differentials between the dominant and non-dominant carriers have continued to erode, and are probably less than half of their pre-equal access (i.e., pre-May 1984) level.

CONCLUSION

In its 1984 Comments to the FCC, the Committee emphasized its support and hope for effective competition in the telecommunications marketplace. At the same time, it expressed its belief that elimination of economic regulation prior to the unmistakable establishment of an effectively competitive market would be premature and would lead to increased prices and less competition in the telecommunications marketplace. The events of this past year have not removed our earlier fears and underscore the critical importance of maintaining in place an effective system of economic regulation until it has demonstrably been replaced by effective, competitive marketplace forces.



Sample based on 45 four and a half minute calls.
 80% of calls are in the day rate period, calls
 are 100, 700 and 2500 miles in length.

EI ECONOMICS AND
 TECHNOLOGY, INC.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR GOLDWATER AND THE ANSWERS

Question. In your testimony, you've characterized the IBM/SBS/MCI transaction as a decision by IBM to *exit* the intercity, long distance market. Others argue that the transaction is an indication that IBM will play a larger role in the long distance

market. Why do you characterize the transaction the way you do? What do you think the IBM/SBS/MCI transaction says about competition in the long distance market?

Answer. While there are a number of inferences that may be drawn from the decision by IBM to exchange its SBS unit for a minority interest in MCI, it is difficult to imagine how this action would imply a "larger role" for IBM in the long distance market. The segment of the intercity transmission market that was the original target of SBS' business plan—specialized, high-capacity data transmission services furnished to a handful of the largest corporate telecommunications users—was never developed as an important component of the overall SBS business stream. Early plans by IBM to offer integrated computer/telecommunications systems and services jointly with SBS likewise failed to become an important element in the overall SBS product line. Indeed, shortly after its network became operational, SBS joined the other facilities-based OCCs in active pursuit of the *retail* long distance market with its Skyline® service. In this regard, it became a direct competitor of MCI's Execunet® and GTE's Sprint®, and of course of AT&T's dominant Long Distance Message Toll and WATS services. However, SBS's share of the switched "long distance" market remained extremely small and, quite uncharacteristically for IBM (which has typically directed its marketing efforts at promoting non-price attributes of its products), has retained its position as the lowest priced OCC long distance service, the "bargain brand" in the long distance marketplace, a policy which appears to play a major role in SBS' ability to attract and maintain the relatively small market share it has amassed up to now. SBS has been operating in a negative profit and negative cash flow condition since its inception, and, although some observers have suggested that the company expected to become profitable in 1987 [see Barrons, July 1, 1985, p. 13] it is not at all apparent that this projection adequately reflects the full impact of the elimination of discounted access charges as part of the equal access implementation. Total investment in SBS, through the end of 1984, has been put at \$1.3-billion [Id.], and SBS' losses in 1985 were expected to run at about \$100-million [Id.] In short, IBM's continued commitment to SBS would have involved a substantial infusion of both long-term and working capital, without any definite prospect for recovery of this investment.

Viewed in this context, it is not at all surprising that IBM would be interested in limiting further losses in this area. One method by which this could have been accomplished would have been for SBS to be shut down entirely and for its physical assets to have been sold off on a piecemeal basis. IBM's deal with MCI was clearly superior to such a "shutdown" alternative. Under the terms of the transaction, IBM assumes all \$400-million of existing SBS debt, transferring the physical assets of SBS, along with its customer base, to MCI on a debt-free basis. There is no cash payment or investment by IBM involved in the transaction, although IBM retains the right to make additional investments and thereby to increase its share of ownership in MCI if it elects to do so in the future. Moreover, while there has been talk of an IBM "promise" to invest an additional \$400-million in MCI over the next several years, it is not apparent that any such investment is actually required as part of the transaction. In addition to the write-offs and assumption of debt on the part of IBM, the transaction also involved a buy-out by IBM of Aetna's 41% interest in SBS for an amount reported to be less than the \$129-million net investment in SBS carried on Aetna's books [Id.]. IBM has indicated that it will also be writing off some unspecified amount of its net SBS investment as a result of the transfer of SBS to MCI.

By its involvement in this transaction, IBM has extricated itself from an ongoing—and costly—involvement in the long distance telecommunications business while at the same time IBM has used its SBS asset to preserve its option to expand its role in and commitment to this field if and when it chooses to do so in the future, but without any obligation to do so. IBM has thus clearly pursued a strategy that places definite limits on what seemed previously to be a largely open-ended funding program.

From MCI's perspective, the infusion of SBS's resources and customers is clearly beneficial, although the net gain may result more from the particularly favorable terms under which MCI acquired SBS's assets and customers rather than from the expansion of the size of MCI's business that will result. In this sense, the acquisition may be viewed as more of a singular infusion of resources than as an ongoing expansion of MCI's activities. Nevertheless, with the combined resources of both firms, MCI will be a stronger company than without the inclusion of the SBS assets; at the same time, the facilities-based intercity services industry will have lost one potentially major player, and will have one less participant than it had prior to the transaction.

It would be premature at best to conclude that the inclusion of SBS's assets and customers within MCI's business will have the effect of making this somewhat larger OCC consequentially more competitive vis-a-vis the dominant carriers than it had been prior to the transaction. The merger does not, for example, materially change the potential cost impact of the elimination of discounted access services, an event whose effect will be essentially the same upon both MCI and SBS, either separately or combined. Moreover, while MCI may be in a position to generate positive incremental profits from its acquisition of the SBS assets and customer base due largely to the "distress price" it was able to pay for these resources, MCI does not have to assume any of the outstanding debt associated with these assets nor does it have to carry them at as much as their former net book value. Thus, whatever relative success the expanded MCI enjoys in profitably utilizing its new resources teaches little if anything about a competing carrier's ability to operate profitably under more realistic economic cost conditions. Hence, while there is little doubt that the transaction served the interests of both IBM and MCI, one cannot conclude that it has somehow made the market any more competitive than it had been before this event.

Question. Dr. Selwyn, you have testified that the costs of premature deregulation far outweigh the costs of maintaining economic regulation while competition is developing. What do you see as the costs and risks of premature deregulation?

Answer. Deregulation of the dominant telecommunications carriers at this time would be premature because it has yet to be established that the underlying economics of supply in this industry can support an effectively competitive marketplace. To the extent that conditions are not conducive to the development of effective competition in one or more segments of the industry, a policy of deregulation of the dominant carriers without regard to the extent of their market power in each major industry segment would impose societal costs in several important areas.

MISALLOCATION LOSSES

If regulatory price and revenue level constraints were removed from a dominant firm with substantial market power that was not otherwise constrained by effective competition, the dominant supplier would be in a position to effect possibly substantial price increases for its products and services, at least in those segments of its overall market in which the presence of and potential for competitive activity is lowest.

Where these products and services are furnished directly to the ultimate consumer (e.g., retail "long distance" telephone service), the excessive prices would cause consumers to curtail their usage of the service (i.e., to consume less of the service than they would under the "competitive result" pricing objectives of economic regulation) and, because the demand for telephone service is generally relatively price-inelastic (i.e., price elasticity less than 1.0), consumers would tend to shift their spending away from other goods and services and into telephone services to partially offset the effects of the higher price levels. In the terminology of economic theory, these "misallocations" would cause consumers to experience a negative "income effect" as a result of the price increases that would occur in a prematurely deregulated telecommunications marketplace, which is equivalent to a net reduction in real disposable income for the consumer.

Where the telecommunications services being provided by the dominant carriers are themselves used as inputs to the production of other goods and services in the economy, the imposition of excessive telecommunications prices will cause the producers of other goods and services to curtail their own production activities, to reconfigure their product mix and production strategy to limit the use of the (now higher priced) telecommunications services, and/or to simply pass on the telecommunications price increases to the ultimate consumer. The precise strategy that a producer would follow in this instance will depend upon the market and demand conditions which he confronts for his product or service, and upon the technical feasibility of altering the product mix and/or production strategy. If one assumes that telecommunications services were being efficiently utilized in the overall production process at their regulated (i.e., cost-based) price levels, then the imposition of non-cost-related price increases will introduce inefficiencies into the overall production and distribution processes for other goods and services in the economy.

To the extent that the telecommunications prices will have been set artificially high (relative to cost) as a result of the unconstrained exercise of market power by the (prematurely deregulated) dominant firms, the resulting disruptions to consumers and producers alike arising from these monopolistically-imposed misallocations of society's resources create "deadweight losses" to the economy as a whole—i.e., the

economy is denied the opportunity to create output and income that would have otherwise occurred, as a direct result of the imposition of excessive, monopolistically determined prices. These disruptions, reductions in real disposable income, and overall deadweight losses comprise a major element of the economic cost of premature deregulations.

EFFECT UPON THE DEVELOPMENT OF COMPETITION

These economic losses are, however, compounded by the fact that the dominant telecommunications service suppliers are themselves large, complex multi-product companies operating across many industry segments each with significantly different present and potential competitive conditions. Opportunities for cross-subsidization from services provided in markets that are not subject to effective competitive flowing to products and services offered in competitive markets would be pervasive. Thus, deregulation of those segments of multi-product dominant carriers that are not yet subject to effective competition creates the risk that revenues obtained through excessive prices in segments of the market confronting little or no competitive activity would be used to cross-subsidize the dominant firms' activities in the more competitive segments. By pursuing such policies, the dominant firms could limit the entry and growth of competitors in those segments of the market in which the underlying economic cost conditions were in all other respects fully conducive to the development of effective competition.

The use of so-called "market-based pricing" of the bottleneck monopoly access services by some Bell Operating Companies provides a graphic demonstration of this phenomenon. In the context of a market in which the local exchange carriers hold overwhelming dominance—access services—the concept of "market-based pricing" translates directly into excessive monopolistically-determined price levels for these services. Even though the aggregate revenue level of the BOCs may be subject to regulatory control, to the extent that these firms would be allowed to impose excessive monopoly price levels on their bottleneck access services, a pool of funds would be created to permit these companies to engage in potentially anticompetitive practices so as to protect other markets that have a potential for the development of effective competition from in fact becoming competitive.

Hence, premature deregulation of the dominant firms can, in addition to creating the losses discussed previously, actually work to frustrate the development of effective competition in those very market segments where, all other things being equal, the economic conditions of supply would permit effective and efficient competition to develop and prosper.

COSTS OF REIMPOSING REGULATION IF COMPETITION DOES NOT DEVELOP

Finally, in assessing the overall economic and societal costs of policies leading to piecemeal and premature deregulation of the telecommunications industry, one should not lose sight of the potentially large costs that would have to be incurred in order to re-establish a regulatory mechanism for one or more industry segments which, after a policy of deregulation has been pursued for a time, remain highly monopolistic and where competition does not in fact develop to a level sufficient to impose price constraints on the dominant firm. To the extent that existing regulatory mechanisms will have been dismantled and their human and other resources previously committed to them will have been redeployed in other areas, substantial costs and delays will be experienced in reconstructing an effective regulatory mechanism even after its need has been clearly established. In addition to the direct costs that will be required to re-establish the regulatory machinery, the economic losses arising from misallocations and improper cross-subsidizations will continue to mount until the new regulatory machinery is in place and is effective.

THE COSTS OF CONTINUED REGULATION

Against all of the costs incident to premature deregulation are the costs that may continue to be incurred where the existing structure of economic regulation remains in effect until the future competitive course of the telecommunications industry becomes more apparent than it is today.

Besides the ongoing costs of maintaining the regulatory processes in place, there are few if any other economic costs that would be attributable to the retention of what those who now perceive the U.S. telecommunications industry as being "highly competitive" would argue is "unnecessary" regulation. The rule of regulation at this stage of the development of the telecommunications industry should be to assure that the dominant firms do not use their market power in certain highly

monopolistic and bottleneck industry segments to impose excessive prices and thereby to cross-subsidize their efforts in more competitive segments. Thus, almost by definition, the central focus of regulators should be precisely on those market segments in which competition is least significant, and to permit valid, cost-based responses by the dominant firms in the more competitively impacted market segments. Regulators should direct their primary attention to protecting against unsupported and economically inefficient price increases in the less competitively-impacted and bottleneck segments; if monopolistic "market-based" pricing can be prevented in these areas, the potential for improper cross-subsidization of the more competitively impacted business activities will be significantly reduced because the opportunities for the dominant firms to accumulate the necessary funds by imposing excessive prices for non-competitive and bottleneck services will have been limited by the regulatory surveillance. The continued presence of economic regulation of the provision of monopolistic and bottleneck services should not interfere with legitimate competitive responses by the dominant firm—the introduction of new and innovative service offerings and new pricing and marketing concepts aimed at stimulating additional demand and hence at achieving a lower overall unit cost level.

Senator GOLDWATER. The next witnesses will be a panel of the Bell Operating Co.: Janice D. Stoney, executive vice president and chief operating officer of Northwestern Bell; James W. Callaway, vice president-marketing, Southwestern Bell; John Prendiville, vice president of technical planning of the NYNEX Service Co.; and Mr. F. Duane Ackerman, executive vice president of marketing and planning, BellSouth.

Gentlemen and lady, you may be seated, and I think we will start with Ms. Stoney.

STATEMENTS OF JANICE D. STONEY, EXECUTIVE VICE PRESIDENT AND CHIEF OPERATING OFFICER, NORTHWESTERN BELL; JAMES W. CALLAWAY, VICE PRESIDENT-MARKETING, SOUTHWESTERN BELL TELEPHONE CO.; JOHN PRENDIVILLE, VICE PRESIDENT OF TECHNICAL PLANNING, NYNEX SERVICE CO.; AND F. DUANE ACKERMAN, EXECUTIVE VICE PRESIDENT OF MARKETING AND PLANNING, BELL SOUTH

Ms. STONEY. Mr. Chairman, members of the committee, I am Janice Stoney, executive vice president and chief operating officer, Northwestern Bell.

My company, along with Mountain Bell and Pacific Northwest Bell, are the telephone company subsidiaries of U.S. West, one of the seven holding companies formed as a part of the AT&T divestiture. Together we provide telephone service in a 14-State area that stretches from Minnesota and Iowa in the Northeast to Oregon and Washington in the Northwest and to Arizona and New Mexico in the Southwest. Northwestern Bell is a five-State company serving Iowa, Minnesota, Nebraska, and North and South Dakota.

I appreciate the opportunity to discuss equal access and long-distance competition. Northwestern Bell has worked very hard to facilitate long distance competition. We have done so because the court has ordered it. We have done so because our customers want it, and we have done so for a good business reason: There is money in it.

In the postdivestiture world, Northwestern Bell is primarily in the information distribution business. We sell access to our telephone network. We sell it to local customers. We sell it to businesses. We sell it to long-distance companies.

If we have properly priced that access, it logically follows that the more we sell the more money we make. We believe that increased competition in the long-distance marketplace will mean increased revenues for us. Competition encourages lower prices. Lower prices stimulate long-distance usage, and that in turn should translate into increased use of our network.

In 1984, fully 37 percent of the revenues of Northwestern Bell, Mountain Bell, and Pacific Northwest Bell were made up of access charges paid by long-distance carriers. That provides us with a very strong incentive to insure that all of those long-distance carriers are satisfied customers. In fact, in the process of converting our facilities to equal access, we have gone the extra mile to enhance competition in the long-distance market.

The divestiture agreement, the modified final judgment, requires the local telephone companies formerly associated with AT&T to modify their facility so that all carriers will have the same type and quality of service as AT&T. The intent is to put all companies on the same footing when competing for potential long-distance customers.

As telephone company switching offices are converted to equal access, the companies are required to notify customers of its availability and give them the opportunity to select a long-distance carrier. Northwestern Bell chose to carry this process several steps further. While every other company in the country initially elected to automatically assign those customers who did not choose a long-distance carrier to AT&T, Northwestern Bell developed a plan to allocate those customers among all the long-distance carriers serving the specific market.

The Northwestern Bell plan, most of which the FCC has recently mandated for the rest of the industry, works this way. Customers are notified of equal access conversion and given a ballot listing the long-distance carriers that will be serving their market. Those who fail to select a carrier are sent a second ballot and are also told to which carrier they will be assigned.

If no selection is made, the allocation of customers who do not select a carrier is according to the same proportion as those who did choose a carrier. In other words, a carrier that attracts 25 percent of the customers who have specified a long-distance company is also randomly awarded 25 percent of the customers who did not choose.

Additionally, rather than scatter equal access conversion throughout our service area, we have focused our first efforts on our major metropolitan markets and clustered the dates at which local offices in those markets are converted. This lessens customer confusion and makes it easier for long-distance carriers to market their services.

Then, too, we have supplied the carriers with extensive data on the demographics and telephone subscriber characteristics of the local telephone exchanges in the major cities we serve.

The ballot and allocation program, the clustering and the free market research were provided without our being ordered to do so by the court, the Congress, the FCC, or State regulators. Rather, we have undertaken those activities as consistent with the procompetitive posture that has been the hallmark of U.S. West since di-

vestiture. We are committed to a telecommunications future of fair, full, and open competition.

That commitment has been underscored by our approach to equal access. However, our commitment to competition stops short of support for price breaks for the competing long-distance companies. We are opposed to a continuation of access discounts for carriers competing with AT&T. These discounts should end as soon as a central office is converted to equal access.

Access discounts, which have been as much as 70 percent below what AT&T pays for access, were established in recognition of the fact that competing carriers were afforded network access inferior to that of AT&T. But once that access is equal, the discounts can no longer be justified.

Continuation of the access discounts would have several consequences. It would give an unfair pricing advantage to those carriers with the discounts, and it would increase AT&T's already tremendous incentive to go around the local exchange network.

Faced with competition from carriers who could buy local access much more cheaply than it could, AT&T would be forced to either build its own facilities or develop other alternatives to the local exchange. In turn, this would threaten the viability of Northwestern Bell. We would sell less long-distance access to our network, so we would have to charge more for local service.

We cannot place in jeopardy the more than one-third of our revenues that flow from our providing the local leg of long-distance calls. We support competition in the long-distance marketplace. We believe that anyone who wishes to enter the long-distance marketplace should be free to do so, ourselves included. But the freedom to compete is both the freedom to succeed and the freedom to fail. Government should not take it upon itself to determine who will win and who will lose in the competitive marketplace.

Northwestern Bell has met the first two time checks on the equal access conversion schedule. The court required that we begin offering equal access by September of last year, and we did so. We were required to have at least one-third of our telephone lines converted to equal access capability by September 1 of this year, and in fact 37 percent of our lines are now converted. And we will meet our September 1, 1986, commitment.

In summary, Northwestern Bell is committed to a competitive long-distance marketplace. We have met and exceeded equal access requirements, pioneering a carrier ballot and allocation process that has since become the standard for the industry. We oppose a continuation of access discounts which, while perhaps enhancing the ability of other carriers to compete with AT&T, would threaten our viability.

We have done our part to foster long distance competition. Government has done its part. The rest should be left to the marketplace.

Thank you. I should be happy to try and answer any questions you might have.

[The statement follows:]

STATEMENT OF JANICE D. STONEY, EXECUTIVE VICE PRESIDENT & CHIEF OPERATING OFFICER, NORTHWESTERN BELL TELEPHONE CO.

Mr. Chairman and members of the committee:

My name is Janice D. Stoney. I am Executive Vice President and Chief Operating Officer of the Northwestern Bell Telephone Company. Northwestern Bell Telephone is engaged in the business of furnishing telecommunications services in Iowa, Minnesota, Nebraska, North Dakota and South Dakota. Prior to January 1, 1984, Northwestern Bell was a wholly owned subsidiary of the American Telephone and Telegraph Company and one of the twenty-two Bell operating telephone companies. As of that date, ownership of Northwestern Bell was transferred to U S WEST, Inc., a Colorado corporation, along with ownership of the Mountain States Telephone and Telegraph Company and Pacific Northwest Bell Telephone Company. These three companies provide telephone service in a fourteen state area stretching from Oregon and Washington in the northwest to Minnesota and Iowa in the east and to Arizona and New Mexico in the southwest. This area constitutes over 40 percent of the land mass of the 48 contiguous states.

Northwestern Bell and the other local telephone companies owned by U S WEST favor a vital, competitive marketplace in which any business enterprise can offer communications services including customer premise equipment, local exchange services and, the main subject of today's hearing, long distance services. We are supporting the development of such a marketplace by converting our local telephone systems to enable all long distance companies to reach local telephone customers on an equal basis. We are working with all long distance companies to carry out the equal access conversion process in ways that facilitate their marketing and other business requirements. And, we are designing and seeking to offer additional access services that will facilitate competition among long distance companies in offering services such as 800 service, operator services and calling card services.

We are also seeking to remove from our own pricing structures the distortions between prices and costs that have built up over many years of regulation. Strong competitive forces are reshaping all aspects of the telecommunications industry. As in any competitive market in our economy, telecommunications consumers will be best served when prices reflect the rigors of competition in the marketplace rather than competition for the ears of regulators or Congress.

I. History of the Equal Access Requirements

Northwestern Bell and the other local telephone companies divested from AT&T on January 1, 1984 are required, under the terms of the agreement breaking up the former Bell System, to provide telecommunications companies that want to reach local telephone customers with access to those customers that is "equal in type, quality, and price to that provided to AT&T and its affiliates." Providing all telecommunications companies that want to reach local telephone customers with access that customers perceive to be equal in type and quality to that provided to AT&T requires modifications of local telephone company plant and equipment. The divestiture agreement specified a phased-in process for making these modifications. With limited exceptions, primarily for customers served by means of older electromechanical technology, which would be very expensive to modify, equal access will be made available as follows: (1) Each divested local telephone company began offering equal access no later than September 1, 1984; (2) At least one-third of all telephone lines provided by the local companies were converted to equal access capability by September 1, 1985; and (3) By September 1, 1986, the local telephone companies shall provide equal access to all telephone lines if such access is requested.

It should be emphasized that the local telephone companies owned by U S WEST are committed to provide equal access to all telecommunications firms whether those firms provide telecommunications services within the local serving areas (Local Access or Transport Areas, or "LATAs," as defined by the divestiture agreement) in which we operate or between these local serving areas and other regions of the country. Indeed, each local telephone company has made an individual written commitment to this effect to the U.S. District Court overseeing the divestiture.²

As local telephone company plant and equipment are modified according to the phased-in schedule outlined above, the local telephone company requests every local telephone customer to designate a long distance company to which all of the customer's long distance calls will automatically be routed.³ Thus, the traditional method of long distance calling when using AT&T's long distance network -- dialing the number 1 plus the area code and telephone number -- will be available to consumers irrespective of the long distance company they use or the type of telephone they use.⁴

The process in which the local telephone company requests local telephone customers to choose a long distance carrier is called the "presubscription" process. The MFJ Court, which initially defined the requirements of the presubscription process prior to a Federal Communications Commission order of May 31, 1985, approved a procedure whereby if a local telephone customer did not "presubscribe" to a long distance company, the local telephone company could send that customer's long distance calls (also referred to as "default traffic") to AT&T, as long as the local telephone company met certain customer notification requirements.⁵

Northwestern Bell chose not to send the so-called default traffic to AT&T. Instead, we developed a presubscription plan that uses two rounds of ballots to encourage customers to indicate their choice of long distance company. Customers who do not indicate a choice are allocated to long distance companies in the same percentages as those customers who do indicate a choice.⁶

To encourage local telephone subscribers to make a choice of long distance company, we undertook a special media campaign seeking to increase customers' understanding of the equal access process. We used print, radio and outdoor advertising to explain the equal access process and organized press conferences for the long distance companies and the media.

Northwestern Bell undertook to handle its equal access deployment process so that insofar as is possible customers in metropolitan areas receive equal access at approximately the same time. This "clustering" of conversions of telephones to equal access capability is responsive to the needs of the marketplace since it facilitates advertising efforts of long distance companies in the metropolitan area markets where long distance competition is most intense. In the words of one of the long distance companies operating in our service area:⁷

"Cultivation of an educated and discriminating customer base provides the best climate for sales and advertising efforts by alternative [long distance companies]. From the beginning, the NWB plan included a significant effort to group central office conversions in order to provide [these companies] with sufficient sales to justify mass marketing investments which could be directed toward education of consumers."

The Northwestern Bell equal access conversion methods were likewise adopted by the two other local telephone companies owned by U S WEST, Mountain Bell and Pacific Northwest Bell, early in 1985. On May 31, 1985, the Federal Communications Commission ordered that a slightly expanded version of the Northwestern Bell presubscription and allocation plan be immediately adopted by the local telephone companies divested by AT&T, by the GTE local telephone companies and by any other local telephone companies voluntarily providing equal access.

The Northwestern Bell presubscription plan has worked well for Northwestern Bell and for long distance companies active in areas served by Northwestern Bell. It has reduced customer confusion about changes in the structure of the telecommunications industry and has facilitated advertising efforts by the newer long distance companies seeking to build a customer base. It has, in the words of the FCC, "encouraged more than double the percentage of customers (60 to 70 percent versus 30 percent) to make an affirmative choice [of a long distance company] compared with the rest of the [former Bell Operating Companies]."

II. What is Equal Access?

The MFJ requires the divested local telephone companies to provide all long distance telephone companies with connections to local telephone customers that are equal in type, quality, and price to those provided to AT&T and its affiliates.⁹ The District Court has discussed what the "equal" in equal access means and has concluded that what is required is that connections be supplied such that "both voice and data customers will perceive no qualitative differences between AT&T transmissions and those of its competitors -- at least with respect to those portions of the transmissions carried by [the local telephone companies]."¹⁰

The Court recognized in this ruling that the long distance telephone companies competing with AT&T will not be disadvantaged in the marketplace as long as the quality of their transmissions over local telephone company facilities is the same as the quality of AT&T's transmissions over those facilities. The Court ruled that providing connections to all long distance telephone companies that are in every way technically identical to the connections provided to AT&T would involve substantial dismantling and reconstruction of local telephone networks without any real benefits either to the consuming public or to AT&T's competitors. Further, the Court noted that the local telephone companies are not responsible for correcting any quality deficiencies that may result from a long distance telephone company's own facilities.¹¹

The difference between connections that are equal in the quality of transmission perceived by the customer and connections that are technically identical is outlined in Charts 1 and 2. Chart 1 is a schematic of the connections provided to AT&T prior to equal access. These connections will continue to be available to AT&T after conversion of an area to equal access.

Chart 2 is a schematic of the types of connections a local telephone company offers to all long distance telephone companies when an area is converted to equal access. Connection can be provided via a direct connection between the local telephone company's "end office" (i.e., the first telephone switching system encountered by a call after it leaves the customer) and the long distance telephone company. (The case of long distance company A in Chart 2.) Connection can also be provided via a second local telephone company switching system, which is called an "access tandem" switch.¹² (The case of long distance company B in the chart.) Or, connection can be provided by a combination of direct connection and tandem access. (The case illustrated by long distance company C.)

All three types of equal access connections outlined in Chart 2 are designed to provide the customer with the same quality transmission and the same probability that his call will not get through due to busy circuits (i.e., with the same "blocking probability"). The number of digits that a customer must dial to place a call is also the same in the three types of connections. Further, the price charged the long distance company for access is the same irrespective of which of the three types of connection is actually used. Most important, the transmission quality from the customer's point of view, blocking probability, required number of digits dialed and price of access are all the same as for the type of connection provided AT&T, as diagrammed in Chart 1.

Further, the procedures that Northwestern Bell and the other local telephone companies owned by U S WEST use in deciding how to route equal access traffic in a particular area -- that is, using direct connections, connections through access tandem switches or a combination of direct and tandem connections -- do not depend on the identity of the long distance telephone company requesting the connections. The type of connection is determined on the basis of the most efficient (i.e., least cost) way of meeting the combined needs of all users of the local telephone company network -- local telephone service subscribers as well as companies that provide long distance telecommunications services.

CHART 1

TYPICAL CONNECTION BETWEEN AT&T AND
LOCAL TELEPHONE COMPANY NETWORK

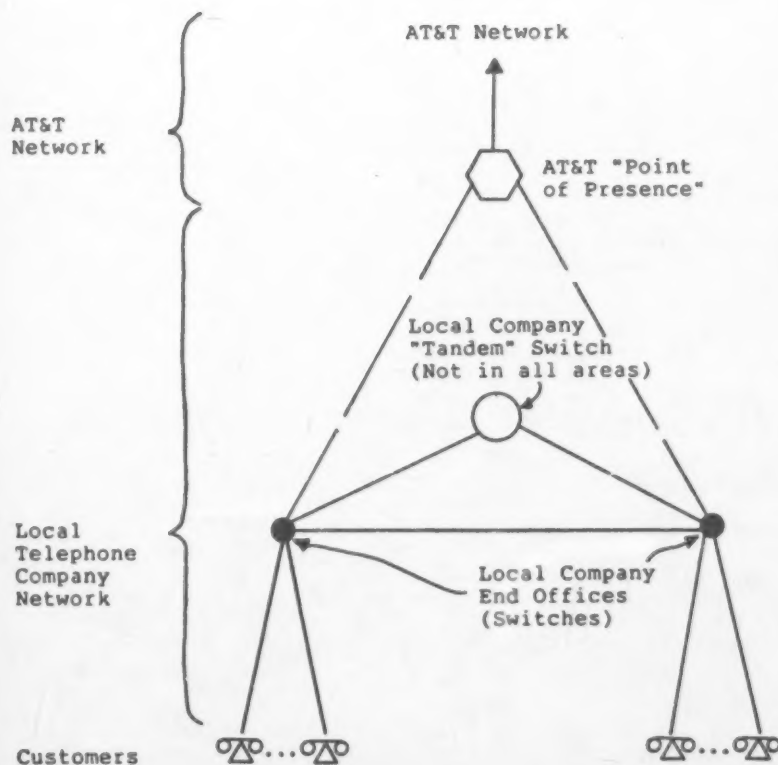
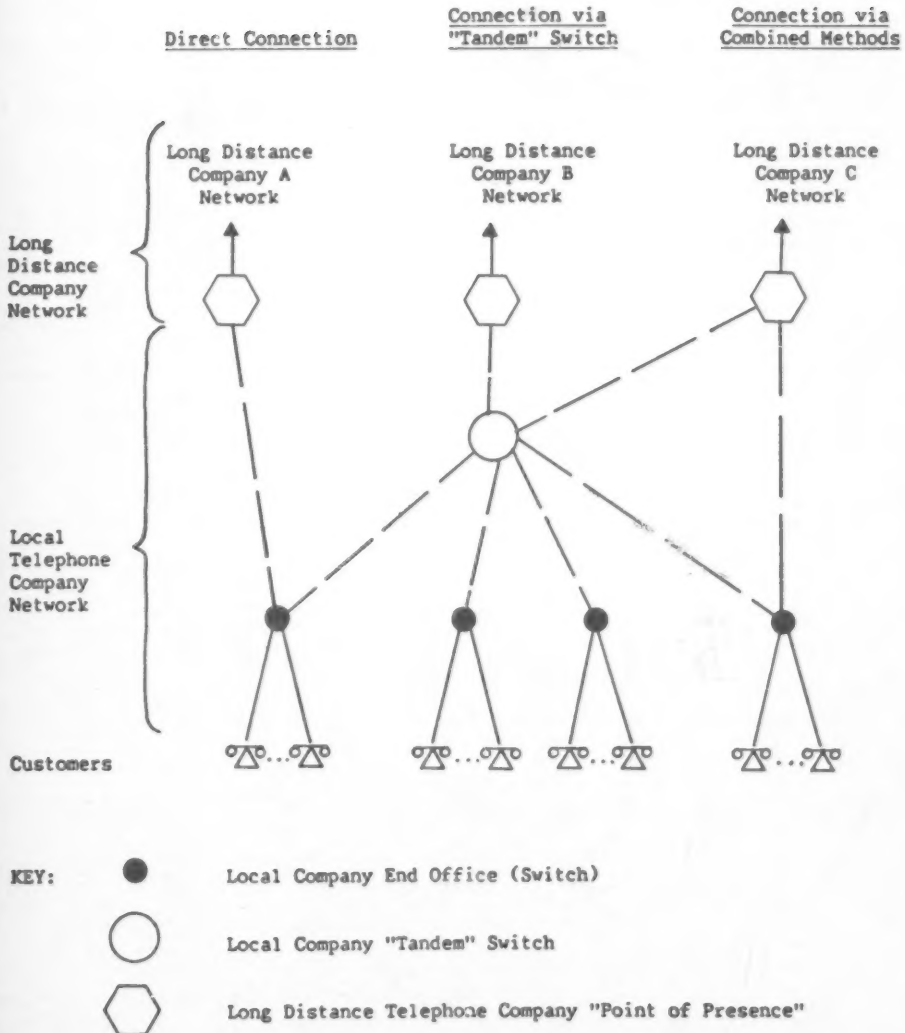


CHART 2

ALTERNATIVE EQUAL ACCESS CONNECTIONS BETWEEN
LOCAL AND LONG DISTANCE TELEPHONE COMPANIES



It should be emphasized that the divestiture agreement does not specify what equipment the local telephone companies must use to provide equal access. This decision has been left to the telephone companies, subject to review by the Court. Indeed, in approving the plan of reorganization that split up the Bell System physical assets at divestiture, the Court indicated that "contrary to some speculation, the Operating Companies had carefully studied the alternatives for the provision of access within their respective territories, and that they had concluded, independent of pressure from AT&T, which arrangements would be most economical and efficient for them."***Given the care which went into the Operating Companies' studies, the Court will not second-guess them by imposing upon them an assignment of switches which they do not endorse...."¹³

Finally, and to reemphasize, the price charged each long distance telephone company for "equal access" quality access to a customer is the same irrespective of the particular local telephone facilities used to deliver long distance calls to and from the customer. Prices are set under tariffs filed with the FCC and are required, under Section B(3) of Appendix B of the MFJ, to be equal, for all long distance companies, per unit of traffic delivered or received within any particular area.¹⁴

III. Equal Access Deployment Schedules

The agreement breaking up the Bell System specified that the local telephone companies divested from AT&T would begin to provide equal access by September 1, 1984, would convert at least one-third of their telephone lines to equal access capability by September 1, 1985 and, upon bona fide request by a long distance company, would convert all lines capable of being converted to equal access by September 1, 1986.

It is highly instructive to compare the MFJ requirements for equal access conversion as of September 1 of this year (one-third of all lines converted to equal access capability) with the actual results in urban areas, which are the areas of most intense competition among long distance companies.¹⁵ Chart 3 presents the results for the largest cities served by the three local telephone companies owned by U S WEST. Equal access is now available to the vast majority of customer lines in these cities, including 85% of all customer lines in Portland, Oregon; 82% of all customer lines in Minneapolis/St. Paul; 79% of all customer lines in Denver; 79% of all customer lines in Des Moines; 78% of all customer lines in Salt Lake City; 73% of all business customer lines in Seattle; and 67% of all customer lines in Omaha. Before the end of this year, equal access will be available to 90% of telephone subscribers in Phoenix as well.

These results demonstrate that the conversion to equal access is largely complete in the major areas served by the U S WEST local telephone companies. Within roughly 12 months, equal access will be available for 90% of all customer lines in Minneapolis/St. Paul; 99% of customer lines in Denver; 91% of all customer lines in Des Moines; 89% of all business customer lines and 71% of all customer lines in Seattle; and 98% of all customer lines in Omaha.

We have met, and exceeded, the equal access conversion schedule established by the MFJ. We will continue to do so. And, we will continue to convert switches to equal access capability after September 1 of next year, the last date specified in the MFJ equal access conversion schedule, in order to meet the needs of all our customers -- individual telephone subscribers and the long distance companies who seek to serve them. After that date, we will convert switches to equal access when the benefits exceed the costs of replacing the switch and when we receive a bona fide request for equal access.¹⁶ Pacific Northwest Bell, for example, will have replaced all of such "non-conforming" switches by the end of 1988 as part of a \$102 million project that will bring end-to-end digital service capability -- and equal access capability -- to its entire service area. As competition in the market for switching equipment continues to drive prices of switches down, it will become cost effective to replace more and more of the non-conforming switches.

It is important to understand the role of tandem switches -- or access tandems -- because the newer long distance companies have claimed that local connections provided via access tandems are preferable to local connections provided via direct connections. As discussed in connection with Chart 2, above, the quality of transmission over local telephone company facilities is equal in both these cases. Also, the price charged for carrying a long distance call over local telephone company facilities does not vary depending on whether access is direct or via a tandem switch.

CHART 3

METROPOLITAN AREA EQUAL ACCESS RESULTS
SEPTEMBER, 1985

(Percent of customer lines converted)

PORTLAND, OR	85%
MINNEAPOLIS/ST. PAUL	82%
DENVER	79%
DES MOINES	79%
SALT LAKE CITY	78%
SEATTLE	73% (business customer lines)
OMAHA	67%
PHOENIX	43% (90% by 12/31/85)

In any case, the local telephone companies owned by U S WEST are moving rapidly to make equal access available via tandem switches wherever this is consistent with the most efficient design of the local telephone network. Northwestern Bell will have completed installation of access tandems to serve the metropolitan areas of Omaha, Des Moines and Minneapolis within the next three months. We will have the capability to serve 85% of all customer lines through access tandems by September 1986. None of AT&T's long distance competitors who have complained about the availability of access tandems serves customers in the three Northwestern Bell LATAs in which access tandems will be installed after September 1986. Pacific Northwest Bell now provides access to 87% of its customer lines via access tandem switches. The installation of two new tandem switches by July 1, 1986 will allow access to all of PNB's customer lines through digital access tandems. Mountain Bell now provides access to 84% of its customer lines through tandem switches. Access via tandems will be available for 95% of its customers by September 1986.

Northwestern Bell and the other local telephone companies owned by U S WEST have responded to legitimate marketplace needs of the newer long distance companies by focusing equal access conversion efforts first on metropolitan areas and by "clustering" the dates at which local telephone switches in those areas are converted to equal access capability. For example, in the Minneapolis/St. Paul metropolitan area, Northwestern Bell converted 32 different central offices containing 862,000 access lines between March and July 1985, resulting in 82% of all customer lines in the metropolitan area being converted to equal access by the end of July. The conversion involved processing 650,000 customer ballots under the presubscription process pioneered by Northwestern Bell and allocating 200,000 lines of customers who did not select a long distance carrier.

These efforts to focus equal access conversions in metropolitan areas and to cluster telephone company end offices for "cut over" to equal access are responsive to the marketing interests of the newer long distance companies. These companies focus their marketing efforts on metropolitan areas because that is where potential customers are concentrated. Within those metropolitan areas, clustering of equal access conversions is important because it enables long distance companies to use television and other mass media advertising to reach potential customers rather than less cost-effective direct mail methods.

Northwestern Bell has also compiled extensive data on the demographics and telephone subscribership characteristics of the local telephone exchanges in the major cities we serve and has provided this information to long distance companies free of charge in an easy to use loose-leaf binder, along with information on the general business climate of the individual states and metropolitan areas in which Northwestern Bell operates. These highly disaggregated data -- including historical and projected numbers of business and residence telephone lines, average usage per line, number of firms by industry classification and the number of their employees in the area, breakdowns of the population by occupation, age and sex and by male and female unemployment and labor force participation rates, numbers of households and breakdowns of those households by income and education levels, breakdowns of dwelling units according to whether owner occupied or rented, by housing value and by amount of rent paid -- are valuable market research information that the long distance companies would otherwise find it time consuming and expensive to collect.

Northwestern Bell and the other local telephone companies owned by U S WEST have attempted to facilitate long distance competition in all these ways. It should be noted, however, that despite their complaints about the equal access process -- and particularly the argument of several of the newer long distance companies that they should receive equal access services at a discounted price until the entire Local Access and Transport Area (LATA) is converted to equal access -- most of these companies have shown remarkably little interest in using equal access connections on a LATA-wide basis.¹⁷

In Northwestern Bell equal access conversions to date, several long distance companies have ordered equal access connections to only some of the available locations within a LATA. In our conversions within the Omaha LATA, for example, US Telecom ordered equal access connections for the converted central offices in the city of Omaha but passed up the opportunity to order equal access connections for central offices in the nearby, smaller cities and towns of Council Bluffs, Crescent, Neola and Underwood, Iowa. Allnet ordered equal access connections for all locations except Neola, the smallest of the central offices being converted. United States Transmission Systems (USTS) ordered equal access connections for 5 of the 7 central offices converted within the city of Omaha and for Council Bluffs, Iowa, but not for Crescent, Neola or Underwood. It later cancelled orders for equal access connections in 3 of the 5 central offices in Omaha for which it had ordered equal access connections, and also cancelled its orders for equal access connections in Council Bluffs. In the Des Moines LATA, USTS ordered equal access connections for converted Des Moines central offices and for the nearby, smaller towns of Granger and Grimes, but passed up the opportunity to order equal access connections for the towns of Colfax, Prairie City and Runnells.

Thus, the newer long distance companies' behavior in the marketplace puts into perspective their argument that they should not pay full price for the equal access connections they do receive until such time as the entire LATA is converted to equal access with tandem switches in place. Many of the LATAs served by the local telephone companies owned by U S WEST are large and contain one good-sized city that these companies are happy to serve along with extensive more sparsely populated areas most of these companies have indicated no interest in serving. In these circumstances, the argument that the newer long distance companies should receive equal access at discounted rates until an entire LATA is converted to equal access must be seen for what it is -- a blatant argument for a subsidy. Further, the issue of discounted rates until tandem switches are in place is moot for the local telephone companies owned by U S WEST, since the installation of tandem switches in metropolitan areas is essentially completed.

IV. Equal Access for Services Other than Traditional Long Distance Telephone Service

When most of us think of long distance telephone service we first think of individual calls we place and pay for ourselves. Many people also use bulk rate services, such as "WATS" (Wide Area Telephone Service), for calls placed for business purposes from their place of employment. Long distance calls that are free to the customer who places the call by dialing "800" prior to the telephone number are also popular with businesses that wish to encourage their customers to call them to place orders or gain information. Operator services, by which the long distance telephone company enables its customers to access a person who will assist the customer in placing difficult or special calls is another familiar service. "Calling card" services enable customers to place calls while away from home and have those calls billed to their home telephone number.

AT&T's long distance competitors would like to provide some or all of these services in competition with AT&T. Northwestern Bell and the other local telephone companies owned by US WEST are designing and seeking to offer access services that will facilitate such competition.

In the case of 800 service, AT&T's long distance competitors have argued that they are at a competitive disadvantage because they cannot make a single verbally significant number, such as 800-CAR-RENT, available to a customer irrespective of the location from which the call originates. This is because they do not have a particular database, which AT&T does have, that enables their networks to perform certain number translation functions.¹⁸

The divested local telephone companies do not have this database either. They have attempted to gain access to the AT&T database, have developed plans for developing their own databases, and have developed plans for supplying alternative 800 service capability to AT&T's long distance competitors in the interim. The MFJ Court decided that the local telephone companies could not have access to AT&T's database and that the local telephone companies are not in violation of the equal access requirements of the divestiture agreement as a consequence. In its decision the Court stated: "The effect of a denial...will simply be to require the interexchange carriers [i.e., AT&T's competitors] to weigh the economic costs and benefits of offering 800 Service at all, or of offering it before or after they or the [local telephone companies] have developed and deployed their own database systems....[It] is not the purpose of the [divestiture agreement] either to punish AT&T or to compensate for the interexchange carriers' economic and technological deficiencies of the interexchange carriers by granting them free access to AT&T technology, equipment, and information."¹⁹

Northwestern Bell and the other local telephone companies owned by U S WEST are committed to developing an access service for 800 service that uses a database -- and therefore allows a customer to retain the same 800 number when he changes long distance company or uses more than one long distance company.

This database will enable an 800 service customer to select multiple long distance carriers for 800 service. The customer will be able to designate one long distance company for 800 service during the business day, for example, and a second long distance company for calls during the rest of the day. The customer will also be able to designate different long distance companies to handle 800 calls from different geographic areas. Thus, the customer could designate one long distance company to handle 800 calls coming from Nebraska during the evening and from Portland, Oregon during the day, a second long distance company to handle 800 calls coming from Nebraska during day, and yet a third long distance company to handle calls coming from Portland during the evening.

The 800 service database capability will also provide flexibility for the long distance companies that offer 800 service. These companies will have the option of receiving from the local telephone company either the 800 number the customer dials or a translation of that number into the actual telephone number that is used in routing the call to its destination. The first option is designed for long distance companies that have or will develop their own 800 service databases. The second option will be of interest to long distance companies that do not want to develop their own databases but do want to compete for 800 service customers.

Where long distance companies request, we will also implement another type of access service for 800 service in the interim before the database type of access service can be developed,²⁰ even though providing both types of 800 service access will be more costly to the industry than developing either type of access alone.

In the case of 800 service, and other services, we are attempting to provide services that will enhance competition in long distance telecommunications. We have been opposed -- increasingly opposed -- in these efforts by AT&T, which is apparently adopting a policy of using the divestiture agreement, which it negotiated, to limit the pro-competition actions of the former Bell Operating Companies.

Thus, we observe AT&T intervening at the Department of Justice to argue that the former Bell Operating Companies cannot provide an 800 service database capability equivalent to AT&T's own because to do so would involve the local telephone companies in the long distance business from which they are at present barred by the divestiture agreement.²¹ Services that would be offered using this database include the translation of 800 numbers into standard telephone numbers which are then handed off to the long distance carrier. This function, which is the function that enables a customer to retain the same 800 number irrespective of the long distance company used, is of a type that is routine in local telephone company operations such as the popular call forwarding service.

AT&T has also intervened before the MFJ Court to argue that the former Bell Operating Companies should not be allowed to provide AT&T's competitors with operator services and with capabilities supporting calling card services, again on the grounds that doing so would involve the local telephone companies in aspects of the long distance telephone business from which they are prohibited by the MFJ.²² These actions are an impediment to the timely delivery of such services to AT&T's competitors. For example, Pacific Northwest Bell is ready and willing now to provide operator services to all long distance companies.

There is a very real threat that the artificial and already outdated MFJ restrictions on activities of the former Bell Operating Companies will be increasingly used by AT&T to delay the introduction of local telephone company services that the newer long distance companies could use to compete more effectively with AT&T -- as well as being used to block participation by the local telephone companies in AT&T's markets at the same time that AT&T is entirely free, under the MFJ, to enter the local telephone service markets.

There is also a very real threat that the regulatory process in general will be used to limit the deployment of technology by the local telephone companies to the detriment of the public.

The Federal Communications Commission has recently recognized this threat:²³

Virtually any new call routing feature that AT&T (or a [local telephone company divested from AT&T]) might propose to introduce can (and might be) challenged [under the FCC's "Computer II" rules that attempt to distinguish between "basic" telecommunications and "enhanced" data processing-like services]. Most of these ... involve use of stored data in the network by the network to set up users' calls, or delivery of information from the network concerning users' calls. While services of this nature ultimately could be used as alternatives to true information manipulation or retrieval services, the ones proposed have not risen to that level. We are asked to bar the introduction of new network capabilities not because of the current proposed uses, but because they might at some time (if ever) become enhanced services. To the extent that we might accept arguments of this nature, the public would be the loser."

V. Implications of Equal Access for Competition

There is a world of difference -- legally and in terms of marketplace relationships -- between a mandate for equal quality connections to the local telephone network by all long distance telephone companies and a mandate for total equality of all competitors in the marketplace. Northwestern Bell and the other local telephone companies owned by U S WEST are committed to provide the former; we do not believe the latter is consistent with an economy such as the U S economy, whose touchstone is competition.

In a competitive economy firms incur startup costs and are seldom profitable in the initial years of their operation; they appropriately view these startup costs as investments.²⁴ Some firms never become profitable and fail, while other firms succeed, reorganize their operations, or enter into mutually beneficial arrangements with other firms, as appropriate. For example, MCI, which is generally considered to be the strongest of AT&T's long distance competitors, is in the process of purchasing another long distance company, Satellite Business Systems, from IBM in a transaction that is reported to leave IBM owning 18% of MCI's stock with the option of increasing ownership to 30%.

Firms operating in a competitive economy do not expect to have their operations subsidized by other firms -- as through the permanently discounted access charges the newer long distance companies are implicitly seeking.

At present, local telephone companies must, under regulatory order, price access services in ways that are inconsistent with marketplace fundamentals. In particular, we must provide access services for AT&T's long distance competitors at a substantial discount below what AT&T pays for access services -- a discount that has been as much as 70%, according to these companies.

These discounts mean that AT&T -- and ultimately AT&T's customers -- must make up the difference. This situation creates incentives for AT&T to go around local telephone company facilities and connect directly to high-volume long distance users. This situation also creates incentives for high-volume long distance users to set up their own facilities to connect with the facilities of long distance companies or to provide complete telecommunications systems of their own.²⁵

Since we have significant access revenues at risk from such direct connections, we want to eliminate the access service pricing distortions as soon as possible. A rapid transition to equal access helps do this, since a long distance company receiving equal access must pay the same as AT&T pays -- for the use of those facilities which are in fact equal access facilities.

A long distance company pays "full price" for access services only to the extent that equal access is available to it. When an individual places a long distance call using one of AT&T's long distance competitors, that company is charged an "origination" access charge; when the call is delivered to an individual elsewhere, the company is charged a "termination" access charge by the local telephone company that serves the individual receiving the call. If equal access is not available for originating access for the telephone call, the company will pay a discounted rate for originating access. When the call gets to its destination, if equal access is not available for terminating the call, it will pay a discounted rate there as well. This means that every one of AT&T's long distance competitor's total expenditures for access services continue to be discounted until all areas in which it originates or delivers long distance calls have been equipped with equal access capability. It is not charged for anything it does not get.

The complaints that have been made by some of the newer long distance companies come down to suggesting that they should receive a discount on what they pay for access services that is in addition to the phased-out discount just described. In effect, they claim that they cannot compete with AT&T unless they can buy a key component of their services at prices that are lower than the prices their major competitor must pay for the very same component. These claims are in stark contrast to the claims made by AT&T's long distance competitors when they were seeking to enter the long distance marketplace nearly ten years ago. Then they argued that they would be more efficient than AT&T because they would use new, technologically advanced plant, would operate with "lean and mean" staffing levels and would have superior, entrepreneurial management.²⁶ They also argued that they could compete by offering new and innovative services.

Long distance companies are important customers of Northwestern Bell and the other local telephone companies owned by U S WEST. Access charges paid by long distance companies constitute a significant portion of our revenues -- 37% in 1984. We want all long distance companies to be satisfied customers. Northwestern Bell, Mountain Bell and Pacific Northwest Bell are concerned, however, that the newer long distance companies seem to place the responsibility for their own prosperity and survival not on their own technological or marketing efforts but instead on manipulation of public policy forums in general and on price breaks received on services provided by the local telephone companies in particular.

In seeking price breaks these companies are implicitly asking that the local telephone companies break a commitment that was made to the U S Department of Justice as part of the divestiture agreement -- an agreement that the local telephone companies divested from AT&T would provide all long distance telecommunications companies with connections to the local telephone company's customers that are equal in type, quality and price. These companies are also implicitly asking that the local telephone companies put their access services revenues at risk -- and thereby put their local service customers at risk with respect to increased local service rates -- by increasing access service prices charged AT&T and thereby increasing AT&T's incentives to go around local telephone company facilities to reach high-volume long distance users. Perpetuation of an access charge discount for the newer long distance companies after equal access is available would do this.

VII. What Should Congress Do?

Is there a problem with equal access to customers served by the local telephone companies? Do problems exist with equal access that threaten competition in long distance telephone service? The answer to both questions is "No." No actions by Congress, by the FCC, state regulators or the Courts are necessary to guarantee that all long distance telephone companies receive access to customers over local telephone company facilities that is equal in type, quality and price to that provided to AT&T.

Competition is a commitment of U S WEST and of the local telephone companies that it owns. Equal access is a part of that commitment to competition. So is our belief that competition -- and the consumers who are supposed to benefit from competition -- are best served when producers have flexibility to decide what to offer consumers and how to produce it and when consumers have flexibility to decide what to purchase. Equal access and flexibility should go hand in hand. As we are committed to providing equal access, we hope that you will be committed to allowing competition to work in all aspects of the telecommunications industry.

¹Modification of Final Judgment (MFJ), United States District Court for the District of Columbia, Civil Action No. 82-0192, entered August 24, 1982, 552 F. Supp. 131 (1982) (emphasis supplied). Equal access requirements of the local telephone companies divested by AT&T are set out in Section II and Appendix B of the MFJ. As discussed in the following section of this statement, the District Court has interpreted access of equal type and quality to be access for which customers perceive no qualitative differences.

²With respect to equal access for long distance companies that want to provide long distance service within the local telephone company service areas, the divested local telephone companies certified: "In accordance with the Court's conditions for approval of the proposed LATAs and subject to state law and applicable regulatory authority, each BOC [Bell Operating Company] hereby commits itself to offer to all interexchange [long distance] carriers intraLATA toll access which is equal in type, quality and price to the intraLATA toll access provided by it to AT&T." Response of the Bell System Operating Companies to the Court's Opinion Establishing BOC LATAs, May 5, 1983, p. 2.

³MFJ, Appendix B. Section 2 (ii).

⁴The customer is not limited to the one long distance company. Rather, the customer can designate a long distance company that will automatically receive any calls dialed by the "1 plus" method just described and still use one or several other long distance companies by dialing "10" plus a three-digit code identifying the particular long distance company and then the area code and telephone number of the called party. This procedure, which is referred to as "10XXX dialing" within the industry, will involve dialing fewer numbers than are now required when using many long distance telecommunications companies other than AT&T.

⁵Opinion, December 7, 1983. 578 F. Supp. 668 (1983), pp. 676-677.

⁶The Northwestern Bell plan has been described by the FCC as follows: "The NWB Plan consists of a two-ballot procedure. A customer is notified of equal access conversion 90 days prior to its occurrence and given a ballot on which to indicate a preference for a primary [long distance company]. Customers who fail to return their ballots to NWB are sent a second ballot giving them another opportunity to choose [a long distance company] and indicating which [long distance company] they will be assigned to if no selection is made. Customers not returning their second ballot are assigned to the designated carriers and allowed six months after the conversion

date to select different carriers without charge. The allocation method employed by NWB is random with respect to customers. The percentage of non-presubscribed customers assigned to any carrier is based on actual presubscription figures." Federal Communications Commission, Memorandum Opinion and Order, CC Docket No. 83-1145, Phase I, Adopted May 31, 1985, p. 3, fn. 7.

⁷"An IC's Perspective on NWB's Approach to Equal Access," by Dennis M. Houlihan, Executive Vice President, Marketing, for MidAmerican Long Distance Company, Omaha, Nebraska, in the July 15, 1985 issue of Telephony magazine.

⁸FCC May 31, 1985 Memorandum Opinion and Order, op. cit.

⁹In discussing equal access requirements the MFJ specifically refers to "exchange access, information access, and exchange services for such access." Definitions of exchange access and information access are found in Section IV of the MFJ. Exchange access and information access include any activity or function performed by a local telephone company in connection with the origination or termination of long distance transmissions and includes functions such as network control signalling, answer supervision, automatic calling number identification, carrier access codes, directory services, testing and maintenance of facilities and the provision of information necessary to bill customers.

¹⁰Opinions of July 8, 1983, July 28, 1983 and August 5, 1983. 569 F. Supp. 1057 (1983), p. 1063 (emphasis supplied).

¹¹Ibid., p. 1063, including fn. 15.

¹²In basic terms, a tandem switch connects two other switches in the telephone network. In contrast, a local telephone company end office is a switch that connects individual customer telephone lines to each other and to the telephone network. The switches differ in their technical characteristics as a consequence of the differing uses of the two types of switches in the telephone network. Also, existing and new tandem switches can differ in their technical characteristics.

¹³569 F. Supp. 1057 (1983), pp. 1064-65.

¹⁴Specifically, the MFJ requires that, until September 1, 1991, "the charges for delivery or receipt of traffic of the same type between end offices and facilities of interexchange carriers within an exchange area, or within reasonable zones of an exchange area, shall be equal, per unit of traffic delivered or received, for all interexchange carriers..."

¹⁵From 75% to over 90% of MCI, GTE Sprint, Allnet, USTS, US Telecom and SBS access connections in the areas served by the local telephone companies owned by U S WEST are found in just eight metropolitan areas (Denver, Des Moines, Minneapolis/St. Paul, Omaha, Phoenix, Portland, Oregon, Salt Lake City and Seattle).

¹⁶There are two exceptions in the MFJ requirements for equal access capability. These exceptions are telephone lines that connect to electromechanical switches, which were in widespread use in the telephone network before computerized switcher became available, and lines that connect to switches that characteristically serve fewer than 10,000 lines. (See Section 3 of Appendix B of the MFJ.) If complaints are raised about equal access capability for such lines, the local telephone companies must demonstrate to the MFJ Court's satisfaction that the relevant switch cannot be converted to equal access capability without incurring costs that are substantially greater than the resultant benefits.

¹⁷MCI and GTE Sprint have ordered equal access connections in all telephone exchanges that Northwestern Bell has converted to equal access to date. However, the Omaha World-Herald recently quoted a GTE Sprint spokesman on Sprint's current plans to concentrate on offering its service to urban areas in Nebraska: "We don't have the size or the resources to serve rurals." (August 6, 1985 issue, pp. 1 and 11.)

¹⁸The issues involved in 800 service are summarized in an opinion of the MFJ Court of January 9, 1985 (604 F. Supp. 316 (1985)). The database in question "translates the 800 Service number to a standard, ten digit 'Plain Old Telephone Service' number contained in the database. That number...continues to route the 800 Service call across AT&T's interexchange network to the subscriber."***800 Service calls [can be routed] to different destinations at different times of day, or to alleviate call congestion at one subscriber receiving location." (Opinion, p. 6)

¹⁹Ibid., p. 18 (footnotes omitted).

²⁰Our plans are to implement the database type of 800 service in October of 1987. This date is contingent on delivery by AT&T of hardware and software for certain components of the database system.

²¹Letter dated May 28, 1985 from Francine J. Berry, Assistant General Counsel, AT&T, to Kevin R. Sullivan, Assistant Chief, Special Regulated Industries Section, Department of Justice. See also, letter dated July 12, 1985 from Richard C. Schramm, Bell Atlantic, to Kevin Sullivan, which responds to the issues raised in AT&T's letter.

²²Letter dated February 15, 1985 from Francine J. Berry, AT&T, to Kevin R. Sullivan, Department of Justice.

²³Amendment of Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry), CC Docket No. 85-229, FCC 85-397, released August 16, 1985, pp. 5-6 (emphasis in original).

²⁴In their more candid moments, AT&T's long distance competitors also accept these marketplace realities. For example, consider the recently reported remarks of the GTE executive responsible for Sprint: "[We] knew [acquiring Sprint] was a long-term investment and that we were building for the future and it would take lots of investment to build the customer base." (Communications Daily, Vol. 5, No. 134 (July 11, 1985), p. 3.)

²⁵For example, a recent newspaper item about McDonnell Douglas Corporation's private telecommunications system quotes the project director of the system: "If McDonnell Douglas were a telephone company, it would be the 22nd-largest in the nation." (USA Today, August 19, 1985.)

²⁶Consider, for example, the remarks of William G. McGowan, Chairman of MCI, over the years in which his firm spearheaded the entry of new firms into the long distance telephone business. In a February 2, 1979 speech to a conference on MCI sponsored by Purcell Graham & Co.: "We can build a system for far less than AT&T has been able to."***We estimate that we construct microwave systems for anywhere from one-tenth to one-half of AT&T's cost."***In addition, I believe we operate far less expensively than Bell." Testifying before the Senate Judiciary Committee on July 23, 1981: "We believe we can construct and operate a long distance communications system in this country far less expensively than AT&T."***For one thing...[we] are not bloated as they are with people and overhead." In a January 15, 1982 talk to the Consumer Federation of America: "AT&T cannot meet the competition now developing in the long distance market. Even its most efficient operation, Long Lines [AT&T's interstate long distance network]...cannot match MCI. Bell spends two dollars and sixty-five cents on plant to get a dollar of annual revenue. MCI, even though confronted with the massive task of building a nationwide communications system from scratch, spends a dollar and a quarter to achieve a dollar of annual revenue." In a September 30, 1982 speech to the Pershing & Co. Annual Research Seminar: "[MCI is] able to respond quickly to opportunity because of a lean management structure, and non-union organization with low overhead. This helps establish MCI as the least cost long distance provider."

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR GOLDWATER AND THE ANSWERS

Question. Do you consider the availability of upgraded "Feature Group D" facilities to be "equal access?"

Answer. Yes, service provided to carriers through Feature Group D is equal in type, quality and price.

Question. Once you have converted an office to equal access, do you provide the same quality connections to all long distance companies—AT&T and its competitors?

Answer. Yes, the same specifications are used for the design, installation and maintenance of equal access connections provided to both AT&T and its competitors.

While the connections will not be identical in all cases, extreme care was taken in the development of transmission plans to ensure that any technical deviations will be so slight that they will be imperceptible to customers. This definition of equality was accepted by the Court in a July 8, 1983 Opinion.

Question. Divestiture is only 20 months old. The transition to equal access, as you have testified, is an enormously complex and unprecedented task. Isn't it possible that when a telephone company office is upgraded to provide "equal access" that there are, at first, technical problems with the new connections?

Answer. Yes, it is possible and some technical problems have been associated with individual office conversions to equal access. Most of the problems encountered were with the first offices converted prior to September 1, 1984. For the bulk of the conversions, technical problems have been minimal and of short term duration.

It is not accidental that problems have been minimal. Conversion procedures which involved cooperative interexchange carrier-NWB pre-cutover trunk transmission and signaling tests and test calls were used for each conversion. These procedures enabled both NWB and the interexchange carriers to identify and correct most technical problems prior to actual service.

Question. MCI has recently stated to the Department of Justice that there are a number of problems with the customer subscription process. What are you doing to ensure that the subscription process works and to ensure that customers who sign up with a particular carrier are in fact connected to the selected carrier?

Answer. NWB is aware of the concerns MCI has raised regarding our presubscription process. We have met with MCI in an attempt to resolve these concerns. As a result, we are in the process of enhancing our presubscription process beyond the requirements of the Modified Final Judgment to meet the needs of MCI and all carriers. Examples are:

(1) Offering to all interexchange carriers a daily update after conversion of their in and out order activity regarding presubscribed interexchange carrier selection.

(2) Offering to all interexchange carriers approximately 180 days prior to conversion a list of end users in the central office so they can begin their marketing efforts early.

(3) Offering to all interexchange carriers a verification of installation in the switch within 30 days after conversion.

NWB is committed to equal access and long distance competition. We have recently performed two audits, by two different audit groups, to assure that our presubscription process is working correctly and end users are subscribed to the interexchange carrier desired. Both of these audits demonstrate there are few errors in the process. The audits are on file with the DOJ. NWB has elected to continue the internal audits on an on-going basis throughout 1985 and 1986.

Senator GOLDWATER. Thank you very much.

All right, Mr. Callaway.

Mr. CALLAWAY. Thank you very much, Mr. Chairman. My name is Jim Callaway. I am vice president-marketing for Southwestern Bell Telephone Co., and I'm the individual with primary responsibility for implementing equal access within our five-State territory.

I would first like to express my appreciation for the opportunity to appear before this subcommittee and express our views and our progress toward meeting equal access as a requirement.

At the outset, let me state that Southwestern Bell is very concerned that some interexchange carriers are attempting to redefine the meaning of equal access. This effort appears to be designed to achieve a continuation of the discount that some interexchange carriers now receive for their connections to the local exchange network.

We at Southwestern Bell strongly oppose any such redefinition of equal access or the equal access obligations of the BOC's. Further, we believe that once we deliver equal access to the interexchange carriers at a given location, they should pay equally for that access.

There are several reasons for our position on this matter. First, the definition of equal access and our obligation to provide equal access to the interexchange carriers was clearly established as a result of the MFJ, the proceedings conducted by Judge Greene and the continuing oversight of the Justice Department, the judge and the FCC.

During these proceedings, all interested parties had the opportunity to express their views and, based upon these proceedings, Southwestern Bell has designed its equal access implementation plan to exceed the externally imposed requirements.

Second, Southwestern Bell has already converted nearly half of its total lines to equal access. This effort has involved the expenditure of enormous amounts of time, money and other resources. It would be patently unfair to redefine our equal access obligations at this stage of the process. Aside from basic equity, significant changes at this late hour would impose additional and unnecessary cost on the industry and its customers.

Third, Southwestern Bell has actively coordinated with the interexchange carriers in an effort to meet their needs in making the conversion to equal access work well for everyone: the industry, the customers and our company. We have utilized a number of procedures to maintain close contact with each of the 170 interexchange carriers that do business in our operating territory. As described in my written testimony, we have often modified and adjusted our equal access plan in order to accommodate the needs of the interexchange carriers.

From the number of customer lines converted, to our plans for rebalotting all customers previously defaulted to AT&T, we feel like we have gone way beyond expectations. However, we continue to remain open to reasonable accommodations to further the objectives of equal access conversion in a timely, efficient and certainly a fair manner.

At Southwestern Bell we see the provision of equal access as more than a legal requirement. We see it as a significant business opportunity. It is clearly in our interest to be proactive in the development of a competitive long distance marketplace.

Equal access provides us the opportunity to develop closer commercial ties with the interexchange carriers who are already among our most valued customers. It enables our business and residence customers to realize the full benefits of competition. It also affords us the opportunity to sell more access services to the interexchange carriers as competition increases the demand for long distance.

So, in conclusion, Southwestern Bell is well on its way to meeting and exceeding its obligation of providing equal access. We aim to accomplish that goal and at the same time to honor our tradition of service to all of our customers. Any redefinition of equal access can only jeopardize that effort and indefinitely postpone the public benefits of long distance competition.

We simply cannot endorse a redefinition process that results in equal access never being achieved.

Thank you.

[The statement follows:]

STATEMENT OF JAMES W. CALLAWAY, VICE PRESIDENT-MARKETING, SOUTHWESTERN BELL TELEPHONE CO.

Mr. Chairman, members of the Subcommittee, my name is James Callaway. I am Vice President-Marketing for Southwestern Bell Telephone Company. Part of my responsibility in this capacity includes overseeing matters related to the equal access conversion process.

I'd like to thank the Senate Commerce Subcommittee on Communications for the opportunity to appear today and represent the views of Southwestern Bell on the important issue of our progress toward delivery of equal access.

Today, there are two major issues I would like to discuss. First, I will describe Southwestern Bell's effort to implement equal access. Included in this will be a discussion of Southwestern Bell's relations with interexchange carriers and end uses and the steps we have taken to implement a smooth transition for all our customers. Second, and of equal importance, I will state our views on the requests now being made by some of the interexchange carriers to redefine the ground rules for the provisions of equal access. The provision of equal access has been an enormous project that has required a substantial commitment of corporate resources. Our mandated equal access obligations are being aggressively met and in fact exceeded. We simply cannot allow a process of "redefinition" of equal access to create a goal that is never realized.

I. SOUTHWESTERN BELL'S EFFORT TO IMPLEMENT EQUAL ACCESS

Let me say at the outset that we, at Southwestern Bell, have always viewed equal access as much more than a legal requirement—it's a significant business opportunity. It provides us with the opportunity to build closer ties with the interexchange carriers who rank among our most valued customers. Additionally, we are enthusiastic about the opportunity to help introduce consumers to the growing availability of telecommunications choices in the marketplace, and by doing so to nurture the competitive environment so vital to the future of the domestic telecommunications industry.

Competition is in the consumer's interest, as well as our own. For the consumer, of course, competition drives prices toward cost; lower consumer prices lead to more long distance utilization and increased usage provides the potential for more access revenues for the local exchange carrier.

We are currently in the midst of an exciting transition in the telecommunications marketplace—moving from a pervasively regulated monopoly industry structure to one of long distance competition. Southwestern Bell recognizes that it is in our best interest to effect as smooth a transition as possible for all of our customers—interexchange carriers, business users and our residential customers. To the extent that all of these customers' needs are being served effectively and efficiently, Southwestern Bell's business interests are also advanced.

In order to take full advantage of the myriad business opportunities available to us as a result of the new competitive realities of the long distance marketplace, Southwestern Bell developed a plan to make equal access work for *all* of our customers. This plan also complies with the legal requirements stipulated in the Modification of Final Judgment, or MFJ, which was approved by the U.S. District Court for the District of Columbia on August 24, 1982. Before I detail some of the steps we've taken to make equal access a reality, let me briefly touch on the MFJ requirements.

The MFJ and Equal Access

The obligation to provide equal access to the local telephone exchange is set forth in Paragraph II.A. of the MFJ:

Subject to Appendix B, each BOC shall provide to all interexchange carriers and information service providers exchange access, information access, and exchange services for such access on an unbundled, tariffed basis, that is equal in type, quality, and price to that provided to AT&T and its affiliates.

In the year following the approval of the MFJ, several questions were raised concerning the technical standards that the former divested Bell operating companies (BOCs) must meet in the establishment of equal access. On July 8, 1983 Judge Greene issued an Opinion which stated:

The Operating Companies assert that any such technical deviations [in the access provided to AT&T as opposed to the access provided to AT&T's competitors] will be so slight as to be imperceptible to all customers, whether of voice or of data. Accordingly, they urge the Court to accept a definition of "equal access" as access whose "overall quality in a particular area is equal within a reasonable range which is applicable to all carriers," and to reject a more stringent definition which would demand access that yields identical technical quality (i.e., identical values for loss, noise, and echo, and identical possibility of blocking).

The Court accepts the Operating Companies' definition and will not insist on absolute technical equality. To do otherwise would necessitate substantial dismantling and reconstruction of local telephone networks without any real benefits either to the consuming public or to AT&T's intercity competitors. This ruling, however, is based squarely upon the Operating Companies' representations that both voice and data customers will perceive no qualitative differences between AT&T transmissions and those of its competitors—at least with respect to those portions of the transmissions carried by an Operating Company. The Operating Companies are well aware, however, that the Department of Justice will be monitoring the quality of the access they will provide and that the price of falling short of their assurance of equal quality will be enforcement proceedings brought by the Department. [Opinion, Pages 6-7, foot-note citations omitted.]

In addition to the definition of equal access, the MFJ also provides a procedure for the "phased-in BOC provision of equal access." Equal access was required to be phased-in on an end office basis according to a stipulated time schedule. According to Paragraph A.1. of Appendix B of the MFJ:

- No later than September 1, 1984, each BOC had to have begun to offer equal access to all interexchange carriers;
- No later than September 1, 1985, equal access must be offered through end offices of each BOC serving at least one-third of that BOC's access lines; and
- By no later than September 1, 1986, upon bona fide request by an interexchange carrier, every BOC end office must be equipped to offer equal access.

One exception to this schedule involves the so-called "nonconforming offices," which are defined in Paragraph A.3. of Appendix B of the MFJ as those end offices that are technologically antecedent to electronic stored program control switches or that characteristically serve fewer than 10,000 access lines. A BOC may be relieved, to the extent and for the time required, from equal access obligations in nonconforming offices if, upon complaint being made to the District Court, the BOC can sustain the burden of showing that the costs of providing equal access clearly outweigh the benefits to users of telecommunications services.

In planning its equal access implementation program, Southwestern Bell responded to priorities communicated by the interexchange carriers, including the replacement of nonconforming offices. In December, 1984, Southwestern Bell notified carriers that, in response to their request, it had accelerated the replacement of nonconforming offices in metropolitan areas during late 1985 through early 1987 so that a greater number of end users might enjoy equal access to the interexchange carriers. Originally, Southwestern Bell had projected that by the end of the first quarter of 1987, approximately 70% of its total access lines would be served by end offices converted to equal access. The accelerated program has raised that figure to approximately 80% of its total access lines.

Approximate increases in the percentage of total lines converted to equal access in some of the major metropolitan areas served by Southwestern Bell are projected to be as follows:

*Increase in access lines converted***Metropolitan area:**

Dallas.....	77.8% to 99.5%
Houston.....	93.6% to 99.3%
Kansas City.....	90.8% to 99.6%
Oklahoma City.....	88.6% to 98.2%
St. Louis.....	88.2% to 98.6%
San Antonio.....	83.8% to 97.1%

The total cost of Southwestern Bell's equal access implementation program is estimated to be \$300 million. However, in pursuing this endeavor, Southwestern Bell will not only meet, but far exceed its equal access obligation imposed by the MFJ. The beneficiaries of this effort will be the interexchange carriers, Southwestern Bell, and their mutual customers, the telephone end user.

Southwestern Bell's Relations With Interexchange Carriers And End Users

Southwestern Bell views the interexchange carriers both as valued customers and as business partners in the provision of telephone service. Southwestern Bell utilizes a number of procedures to maintain close service coordination with each of the more than 170 interexchange carriers that do business in Arkansas, Kansas, Missouri, Oklahoma, and Texas.

Southwestern Bell assigns an Account Manager to each interexchange carrier, and the Account Manager acts as the point of contact for the interexchange carrier on all business matters. The Account Manager becomes familiar with the interexchange carrier's business and attempts to ensure that the carriers are satisfied with Southwestern Bell's service. Interexchange carriers have raised literally hundreds of issues and questions in contacts with their Account Managers. Southwestern Bell and the interexchange carriers have generally resolved any problems that have arisen, often through changes in Southwestern Bell's procedures. Even in situations where the parties could not reach total agreement, the process has reinforced our commitment to the successful transition to a competitive long distance marketplace.

Southwestern Bell maintains an official mailing list of interexchange carriers so that timely and relevant information may be distributed to those customers. Furthermore, Southwestern Bell regularly and formally solicits comments from the interexchange carriers by sending out a customer perception questionnaire. The questionnaires provide the interexchange carriers with the opportunity to rate Southwestern Bell's performance in the following four areas: marketing, billing, provisioning, and maintenance. Answers to the most recent questionnaire reveal a widespread level of satisfaction with Southwestern Bell's overall performance.

Southwestern Bell also holds several conferences each year to discuss relevant topics with the interexchange carriers. During each of the two conferences held annually, Southwestern Bell make its subject matter experts available for questions from the interexchange carriers' representatives. Southwestern Bell hosts other conferences to discuss local tariffs or specific, one-time issues. Numerous interexchange carriers attend the conferences, and the feedback from attendees has been extremely positive.

An equal access issue that has received much public attention in recent months is the treatment of calls originated by customers who do not select a primary interexchange carrier at the time their serving end office converts to equal access. Most BOCs, including Southwestern Bell, initially used the District Court-approved procedure of continuing to route such traffic to AT&T. During early 1985, however, Southwestern Bell began reexamining that position in light of the experience Northwestern Bell Telephone Company and the interexchange carriers had gained with a ballot and allocation plan. On April 4, 1985, Southwestern Bell filed Comments with the FCC and made the following statement:

Although Southwestern Bell would incur additional costs over and above those associated with the existing default plan, the advantages of an allocation plan appear to outweigh the disadvantages. Therefore, Southwestern Bell supports the use of a ballot and allocation plan and desires to implement such a plan as soon as possible. [Page 11.]

In a Memorandum Opinion And Order adopted on May 31, 1985, and released on June 12, 1985, in CC Docket No. 83-1145, Phase I, the FCC ordered the BOCs to implement ballot and allocation plans as soon as possible. Since Southwestern Bell had analyzed and had begun to implement the necessary steps for the commencement of such a procedure, our Company was in a position to proceed expeditiously

with its ballot and allocation plan. The first ballots were mailed to customers in early August, and their serving end offices will be converted to equal access on November 1, 1985.

Since a substantial number of end offices were converted to equal access prior to May 31, 1985, the date of the FCC order and of mandatory prospective allocation, Southwestern Bell has proposed to "revisit" those offices converted to equal access prior to May 31, 1985 and to retroactively ballot and allocate those end user customers previously defaulted to AT&T. By timing the "revisitation" schedule for major metropolitan areas to coincide with the natural groupings of remaining end office conversions, Southwestern Bell will be able, to a great extent, to produce a geographic grouping effect in those areas. Southwestern Bell anticipates that this geographic grouping will assist the interexchange carriers in their marketing campaigns, since, in many cases, a large number of customers within a specific metropolitan area will receive ballots within a short period of time.

During the transition to equal access—which is taking place during one of the most complex industry reorganizations in history—certain transitional implementation questions have inevitably arisen. Rather than take an adversarial posture with respect to resolving these issues with the interexchange carriers, Southwestern Bell has taken the position that it is mutually advantageous to expeditiously and fairly resolve any questions that might arise. This is because we view the interexchange carriers as vital partners in the provision of high quality telecommunications service to residential and business customers.

In August, 1984, three interexchange carriers petitioned the FCC to establish and chair a forum for equal access implementation problem resolution. MCI Telecommunications Corporation, Southwestern Bell and others opposed that proposal. MCI stated that equal access problems are best addressed through "direct bilateral negotiations between the individual carriers involved." [MCI Comments, August 30, 1984, Page 3.]

Southwestern Bell's Comments, filed with the FCC on September 24, 1984, pointed out that several organizations are already in existence to provide exchange and interexchange carriers with the opportunity to discuss and resolve equal access implementation problems that may arise between them. Those organizations include (1) the National Operators Forum (NOF), (2) the Interexchange Carrier Compatibility Forum (ICCF), (3) the Cellular Service Compatibility Seminar (CSCS), and (4) the Interexchange Customer Service Center Panel (ICSC Panel). In particular, the NOF provides an opportunity for subject matter experts of participating companies to meet and discuss the resolution of common operational problems, including those related to the implementation of equal access.

On January 17, 1985 the FCC released a Memorandum Opinion and Order addressing the issue of equal access problem resolution raised by these three interexchange carriers. In the Order, the Commission essentially endorsed the concept of resolving any equal access implementation question through existing industry-wide groups. The FCC further noted that it would participate in the problem resolution process only as an observer, stating that if an interexchange carrier's problem amounted to a violation of the Communications Act of 1934, as amended, the FCC's complaint procedures would be available for its resolution.

While we believe strongly that our program is serving the needs of the interexchange carriers, we have not lost sight of the special needs of our other equal access customers—the end users. We realized—along with several consumer groups—that equal access was potentially confusing to end users. Therefore, we developed an equally comprehensive plan to meet the informational needs of consumers.

We produced two informative booklets related to equal access as part of our ongoing residence customer information program called—Tele-Help. Consumer response to those informational aids has been impressive. To date, we have distributed over 860,000 copies of "A Guide to Selecting A Long Distance Company," and almost 600,000 copies of "A guide to Easy Access Dialing."

Since equal access is an ongoing process, we intend to include these booklets in a special Tele-Help information campaign for small business customers.

Southwestern Bell was among the charter supporters of the Tele-Consumer Hotline sponsored by TRAC—the Telecommunications Research and Action Center. According to our latest data, their hotline receives approximately 700 calls per month from customers in our territory. Many of these customers are referred to the hotline by our contact employees if they seek information about products or services which we are not allowed to provide under the MFJ prohibitions.

Our information effort also includes the direct mail materials we provide end users during the presubscription process. We have gone to great lengths to test and retest these materials to make them as easy as possible to comprehend.

II. SOUTHWESTERN BELL'S VIEW ON REDEFINITION OF EQUAL ACCESS

I now wish to address the spectre of a "redefinition" of our equal access implementation obligations. At the conclusion of the Federal Government's seven-year antitrust suit against the Bell System culminating with divestiture, the BOCs had imposed upon them an obligation and a schedule to achieve equal access. Nevertheless, Southwestern Bell, as well as the other divested BOCs, developed an aggressive plan to meet their legal responsibilities under the MFJ. The definition of equal access in addition to the BOCs' plans for implementation, received close scrutiny and approval from the DOJ and Judge Greene. The entire equal access conversion process to date has taken place under the watchful eye of Judge Greene, the DOJ, FCC and the interexchange carriers themselves. Yet, now as this complicated, enormously expensive, and often confusing task is more than halfway completed, we are beginning to hear some interexchange carriers call upon the policy-makers to "redefine" the meaning of equal access, the manner in which it is provided, and the obligations of the BOCs. We, at Southwestern Bell, strongly oppose any such effort. To redefine equal access at this time is tantamount to a request for an extension of the discounts that certain interexchange carriers now enjoy.

Let me now turn to but several of the specific proposals being suggested by the interexchange carriers. A number of interexchange carriers have requested that they continue to receive equal access charge discounts until they receive access through tandem switches. According to these interexchange carriers, the alternative to tandems—direct trunks from an interexchange carrier point of presence to an exchange carrier's central office—is more costly and therefore justifies continuing the discount. This proposal is a radical change from the original plan, which promised the local exchange carriers payment of equal access charges upon delivery of equal access. This is, however, virtually a moot issue in Southwestern Bell's five-state service territory. Today, 85% of our lines that have been converted to equal access are routed through tandem switches; that percentage will increase to 96% over the next four months, and be nearly 100% by the end of next year.

Some interexchange carriers also contend that phasing-in equal access end office-by-end office, rather than on a LATA-wide basis, hampers their marketing efforts. It's important to note here that we could well have originally planned to phase-in equal access on a LATA-wide basis, or some other method for that matter, but we were not asked to. Instead we were asked to phase-in equal access in as many end offices as possible as quickly as possible. That plan is now less than 12 months from completion. To ask us to change this previously agreed upon method now, one year before the transition to equal access is largely complete is inappropriate. It takes nearly a year to plan for and convert an end office to equal access, using the combined skills of network, engineering, and marketing personnel. Any change in the current plan could jeopardize the scheduled completion of the equal access conversion process, and impose additional costs on the industry and its customers. Moreover, such a change would raise serious questions of equitable treatment among the competing interexchange carriers.

We believe that the combined effects of our decision to retroactively ballot and allocate customers previously defaulted to AT&T and our exchange grouping plans will fully satisfy the reasons given for this proposal, and thereby obviate any need for a change in the current plans.

CONCLUSION

I wish to close by stating a number of facts which must not be forgotten as the debate continues on this issue. Southwestern Bell is well on its way to meeting its obligation to provide equal access as mandated by the MFJ. Moreover, Southwestern Bell will far exceed those minimum requirements, for to do so is in the best interest of the interexchange carriers, the end user, and Southwestern Bell itself. We intend to accomplish this goal and to fulfill our tradition of service, while at the same time meeting the needs of all of our customers. Any effort to redefine our equal access obligation, or to continue discounts whereby some interexchange carriers are relieved from responsibility for paying equal rates for equal access will not be in the best interest of the telephone industry or the American people.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR GOLDWATER AND THE ANSWERS

Question. Divestiture is only 20 months old. The transition to equal access, as you have testified, is an enormously complex and unprecedented task. Isn't it possible that when a telephone company office is upgraded to provide "equal access" that there are, at first, technical problems with the new connections?

Answer. Yes, it is possible.

When an office is first upgraded to provide "equal access," there are two categories of potential technical problems. One is where the office upgrade is the first application of a particular software program and the other is where it is the first time to interconnect with a particular long distance company office. The latter could be a new "switch" of an experienced company or a first-time long distance company.

SWBT addresses the first category by building into its first software application schedule additional preconversion test time. This allows full testing of the new software program, obtaining vendor assistance if necessary and identification of any new or different impacts on all types of calls and features.

The second category is addressed through SWBT's procedure of establishing precutover testing schedules with each participating long distance company. SWBT jointly tests with each long distance company. SWBT also offers the long distance companies the opportunity to participate in precutover call-thru testing which not only tests the "new connections" but tests all circuits involved in a call from origination to termination. This includes making test calls from each type of line to verify the accuracy of routing and the recording of billing information by the switching machine.

Even with these elaborate tests, there have been a few cases of customer affecting problems, but overall these test procedures have resulted in high quality equal access cutovers of Southwestern Bell offices.

In all office conversion situations, SWBT has on-site personnel at the time of actual cutover to insure successful live operation of all long distance company interconnections. SWBT's technical support organizations are also available at this time for "hot line" assistance should any problems appear.

Through the above approach, SWBT makes every attempt to insure any technical problems are identified and corrected prior to the conversion and to be in a position for immediate action on any that may appear at the time of actual cut to live operations. It should be recognized that the success of this approach is dependent on the cooperation and participation of all long distance companies.

Question. Once you have converted an office to equal access, do you provide the same quality connections to all long distance companies—AT&T and its competitors?

Answer. Yes, the connections are engineered, installed and tested to assure meeting the same high quality standards, as described by the Modified Final Judgment.

Question. MCI has recently stated to the Department of Justice that there are a number of problems with the customer subscription process. What are you doing to ensure that the subscription process works and to ensure that customers who sign up with a particular carrier are in fact connected to the selected carrier?

Answer. Southwestern Bell Telephone has several controls in place to ensure that the presubscription process works and that the customer is translated to the selected carrier of their choice. SWBT's order completions procedure requires a two step process be accurately implemented: First, the appropriate carrier selection has been entered into the billing database and, second, the appropriate carrier selection has been translated into the switch. This is the same procedure SWBT uses for all central office order completion and is not unique to equal access. To assure these requirements are met for the equal access subscription process, these additional steps have been implemented:

(1) An Equal Access District to oversee and coordinate the successful implementation of Equal Access/Easy Access Dialing has been established at company headquarters.

(2) Each state has an Equal Access Administrator to oversee and coordinate the successful implementation of Equal Access/Easy Access Dialing within the state.

(3) Specialized Service Order Resolution Groups have been established in each state to assist the order process and to assist the carriers with questions.

(4) Equal Access/Easy Access Dialing Review Procedures, beginning with the official notification to the carrier through the entire process, have been implemented by a review team to ensure the process is working.

By bringing these specialists' expertise and authority to cut through normal channels to bear on the accurate resolution of presubscription orders, we have established a means to promptly address customer order issues of an individual, local or

general nature. A recent study conducted at the request of the Department of Justice indicated a .6% customer affecting error rate. Although our error rate is minimal, SWBT continues to research ways to improve accuracy. For example, billing and switch comparison is under development to ensure that the customer is translated to the carrier of their choice.

Question. Do you consider the availability of upgraded "Feature Group D" facilities to be "equal access?"

Answer. Yes. This view is consistent with the provisions of the MFJ defining equal access and the descriptions of equal access underlying FCC requirements established for the conversion process.

Related to the physical conversion are requirements for advance notifications to customers and interexchange carriers, ballot and allocation processes, etc. These are not descriptive of "equal access" as defined by the Court and the MFJ, but are recognized and accepted responsibilities attending the conversion. In all cases, SWBT is meeting or exceeding its requirements and responsibilities.

Senator GOLDWATER. Thank you. Just a question.

What does Southwest cover?

Mr. CALLAWAY. We cover Missouri, Arkansas, Oklahoma, Kansas, and Texas.

Senator GOLDWATER. I just wondered. I am from the Southwest. Everybody says they are from the Southwest.

Mr. CALLAWAY. You are just a little further Southwest than we are.

All right, Mr. Prendiville.

Mr. PRENDIVILLE. Good afternoon, Senator. My name is John Prendiville, and I am vice president, technical planning, for the NYNEX Service Co.

Development of competition in the long-distance telephone market is vital to the NYNEX Telephone Co's. Divestiture required us to expend huge resources to reconfigure our local networks to provide equal access to all inter-LATA carriers. Thus, it is clearly in our interest to have competing carriers use that access.

The strength and the future of the NYNEX Co's. lie in our local networks. Our future depends upon customers remaining on that network and using it to reach their interexchange carriers. For this reason alone, our commitment to universally available, affordable telephone service is as strong today as it was in the past.

We, however, are not the only game in town. Interexchange carriers have a variety of options to connect their services directly to high volume customers and bypass our networks, and the current access pricing encourages them to do so.

AT&T is particularly active in this area. For example, its new software defined network and Megacom services use AT&T's large number four electronic switching system to provide dial tone directly to customers. In fact, SDN and Megacom are not new services. They are pricing schemes to drive certain segments of the business population to bypass the local networks. Other companies will surely follow this pattern.

Unless we are allowed to price our access services competitively, we will be shutout of this market. The results will be higher costs, and less value for the remaining small business and residential customers.

Recently we and the other former Bell System companies have come under attack from some interexchange carriers regarding our provision of equal access. Insofar as the NYNEX Telephone Cos.

are concerned, I can assure you these charges are unfair and unsupported.

The divestiture agreements required us to establish a very ambitious schedule of equal access. We have exceeded those requirements. Within the space of 2 years we will provide the interexchange carriers a market of almost 8,000,000 equal access lines. These conversions are a huge and a complex task. Some problems were expected.

The conversion to equal access is by far the largest, fastest change we have ever made in our networks. Unlike past network changes, we've had no comparable experience to rely on. But as problems have come up they have been quickly resolved.

I am proud to say that we have met our equal access conversion objective. We have been flexible in changing our plans where experience dictated and will continue to work closely with the interexchange carriers to assure this successful transition to equal access.

Some carriers have complained about the schedule for the deployment of access tandems and office conversions. These claims are discussed in detail in my written testimony. You should understand, however, that these schedules were the direct results of the original requirements.

Where possible, we concentrated our initial efforts in our major metropolitan areas. For example, by September 1986, 75 to 80 percent of all of the access lines in Manhattan and the greater Boston area will be converted. Further clustering of conversions has never been possible.

Because equal access is a vital part of our future, NYNEX is not content with merely meeting the minimums required by the decree. We want to grow our business and help competition thrive by improving our local exchange and our access services.

By adding new and improved local services, we can encourage carriers and customers to use our network to access intra-LATA service. For example, we plan to provide truly equal 800 service access. We are also developing plans to provide operator and other enhanced access services. Some of these access services are opposed, particularly by AT&T, and are now being reviewed by the Department of Justice. We trust that ultimately we will be permitted to provide these services.

Finally, I would like to emphasize that we at NYNEX do not believe that specific congressional action is needed or desirable at this time. The FCC is keenly aware of the problems the industry faces in the transition to full competition, and has developed policies to guide that transition. Its recent orders on presubscription balloting and allocation and its plans to reexamine Computer Inquiry II rules are two examples.

While hearings such as these serve the purpose of keeping the committee aware of the developments, the FCC policies should be given a full, fair opportunity to work.

Thank you.

[The statement follows:]

STATEMENT OF JOHN F. PRENDIVILLE, VICE PRESIDENT, NYNEX SERVICE CO.

I. INTRODUCTION

I would like to thank the Committee for giving NYNEX the opportunity to address one of the most important topics today in the telecommunications industry—equal access. The purpose of my testimony is to explain what we at NYNEX are doing to provide equal access to our customers. I will also describe the process that we have developed at NYNEX to make it easier for our customers to presubscribe to any of the long-distance companies that provide service in the NYNEX area. Finally, I would like to comment on what NYNEX can, and hopes to do to help promote competition in the marketplace.

There are, however, two critical points that I would like to emphasize at the very outset. First, I would like to assure the Committee that the NYNEX Companies remain fully committed to the concept of universally available, high quality, affordable telephone service. Keeping as many of the citizens of the jurisdictions we serve connected to our modern networks, and promoting the usage of these networks is the basic underpinning of our future business success. While we have the responsibility and commitment to serve residential and business users of all sizes in all locations, our services now face increasing competition from firms who are targeting their services only to the larger business market, which has traditionally been the more profitable portion of the business. Unless we are given the opportunity to fairly compete for this upper end of the market by providing new and competitively priced services, there is a real danger that we will be unable to meet the needs of our small business and residential customers for modern, reasonably priced telephone services. If there is going to be competition, it is essential that all providers of service be allowed to compete on the same basis.

Second, NYNEX is firmly convinced that there exists no need at this time for Congress to become involved in the equal access transition process. While the requirement for equal access stems from the Divestiture Decree, as to which the Department of Justice and the Court have enforcement duties, the FCC, which has responsibility for implementing for our nation's Communications policy, is also playing a vital role in the transition to equal access. The FCC has devised a plan under which the newer carriers pay for access on a phased-in basis as the benefits of equal access are realized. And recently the FCC has involved itself in the equal access pre-subscription process in a way which further assists the new carriers in developing their customer base. The FCC ballot and allocation plan, which I will discuss later herein, has the potential for not only promoting greater use of equal access where it is available, but may also substantially increase the customer base of the newer carriers. We at NYNEX are confident that the Commission will continue to monitor the process and make further changes as needed. The FCC is in a far better position than Congress to monitor and adjust the process as necessary, and should be given the full opportunity to do so. The FCC's efforts should be given a full and fair opportunity to work.

II. EQUAL ACCESS

A. Definitions

The first issue that I would like to address is equal access. We all know the process of making a long-distance phone call used to be quite simple. A customer would normally dial 1 + the area code + the 7-digit telephone number being called. Until a few years ago, the call would have been carried over the long distance network of the Bell System and numerous local independent exchange telephone companies, a network that took over 100 years to design and build.

Beginning with the advent of competition in the long distance marketplace, there has been another option for placing long distance calls. Customers choosing a long distance carrier other than AT&T have had to dial up to 24 digits to place their calls.

Today, as a result of "equal access", a customer, in many parts of the region served by the NYNEX Telephone Companies, can dial 1 + the area code + the 7-digit number and have his or her call go over the lines of any one of a number of carriers chosen by the customer. In other words, using the direct dialing method, a customer served by an equal access office now has the opportunity to select which long distance carrier will transmit his or her call.

B. Commitment

Equal access is a key element of the Modified Final Judgment that dictated the terms of the divestiture of the Bell Telephone Companies from AT&T. The process

of implementing equal access is a tremendous undertaking in terms of labor, expense, and capital investment, and has involved almost every department in the NYNEX Telephone Companies. All of these efforts are absolutely necessary to provide all interexchange carriers with the same opportunities to offer high quality service to their residential and business customers.

The success of the other interexchange carriers can be greatly enhanced by the success of equal access. With equal access all interexchange carriers will be able to provide 1+ dialing to their customers.

NYNEX is committed to providing equal access service as soon as possible. This commitment has been explicitly set forth in the detailed Equal Access Plan filed with the Department of Justice a year and a half ago. The successful implementation of this plan is no less important to NYNEX than to the interexchange carriers. We consider healthy, competitive long distance marketplace to be essential to our long term business success.

C. Equal access network goals

NYNEX's current and future business strength is our modern local exchange networks, and the services, including equal access, which it provides to the people who are connected to those networks. It is clearly in our long term interest to keep as many people as possible on the NYNEX networks and to promote usage of that network. As equal access becomes more widespread it will make our local access services more valuable to both the customers and the interexchange carriers. The more choices a customer has and the more features available, the greater the role the local telephone company will play in the telecommunications market. Our local networks are, and can continue to be, the gateway to the interexchange networks of all carriers.

By entering the network through one point, a customer can take advantage of the different service offerings of various carriers. With only one interexchange carrier, there would be little need for a customer to use the local telephone company to connect to that carrier; he or she might as well connect directly with that carrier. The more carriers available to the customer the greater that customer's incentive will be to leave his or her options open for taking advantage of them all using the local telephone company.

It is thus clear to see why NYNEX has not only met, but in fact exceeded the legal obligations for equal access set forth in the Modified Final Judgment (MFJ). The provision of equal access is not only a requirement of the MFJ, it is a key part of the NYNEX business goals. We have utilized large numbers of technological and human resources to meet this goal, and by the end of 1986, NYNEX will have spent approximately \$256 million just to provide equal access service.

D. Accountability

In its equal access plan, NYNEX designated specific executive level officers, including myself, to assume the responsibility to oversee the planning and implementation of the conversion of its offices to provide equal access. A schedule of office conversions to equal access was developed through September 1986 and interexchange carriers were notified so that they could coordinate their marketing and provisioning activities. The NYNEX Equal Access Officers review policy matters and the status of the conversion efforts on a weekly basis at a minimum, and currently meet monthly in full day formal review sessions.

E. Joint Efforts

NYNEX has and will continue to meet with the interexchange carriers to make equal access work. We have held four conferences with the interexchange carriers in the past thirteen months. We participate in national industry fora: for example, the Interexchange Carrier Compatibility Forum, the National Operations Forum, and the Ordering and Billing Forum. Also, we conduct one-on-one planning and conversion meetings with individual interexchange carriers. We have given the interexchange carriers training on order placement, and we publish a monthly newsletter to keep carriers informed of developments at NYNEX. Thus, NYNEX and the interexchange carriers have worked and shall continue working together to make equal access a success in the states in which we operate.

F. Experience

The process of providing equal access in the NYNEX region has been an evolutionary one. We have learned a great deal from our experiences of the past several years. Although the philosophy of our companies is to "do it right the first time," in the case of equal access we have not had the benefit of past experience to rely on. We consider equal access provisioning and the presubscription process to be one of

the most significant and complex tasks ever undertaken in our history. Between September 1984 and September 1986, we will have converted 415 central offices, provided the new equal access service to 7.9 million telephone access lines, educated almost 8 million customers on equal access and dramatically reconfigured a large part of the network it took us 100 years to build.

G. Scope of Task

The task of equal access is not only an enormous one, it is a complex one. The nationally integrated network that existed before divestiture was designed so that one telephone customer could call another telephone customer anywhere in the country using Bell System and Independent Company facilities. Hundreds and thousands of pieces of equipment were designed, manufactured, engineered and installed as part of this integrated network.

Massive systems development work is required to make the transition to equal access for our 9.4 million residential customers and 1.3 million business customers in the NYNEX region. This work began in early 1982, after the signing of the Divestiture Decree. Equal access software and hardware had to be designed, developed and manufactured for our electronic software based switching systems. In addition, new administrative systems relating to the receiving, processing, completing, and billing of presubscription and interexchange carrier facility orders had to be designed, developed, tested, installed, and connected with existing mechanized systems. For example, equal access changed how operators handle calls; it required new formats for customer and interexchange carrier bills; and it required new types of recorded messages to acquaint customers with different long distance access procedures. All of this had to be done without disrupting existing service to our customers. Virtually all departments and disciplines within the NYNEX organization were and are involved in this process.

The commitment and dedication of resources made by the NYNEX Telephone Companies has permitted them to meet the schedules for converting local and access tandem offices to equal access capability. In the NYNEX service region, 199 local offices were converted on schedule through September 1, 1985. Each conversion, which involves hardware additions, software changes, and network reconfigurations normally requires 18 months to complete.

In the two years between September 1, 1984 and September 1, 1986, equal access capability will be provided for almost 8 million access lines, large numbers of which are concentrated in the large NYNEX urban areas. That is, 75 percent of all access lines in Manhattan and 80 percent of all access lines in Greater Boston will have been converted to equal access by September 1, 1986.

We at NYNEX are proud of the progress we have made thus far and remain fully committed to achieving our goal of providing equal access capability throughout the NYNEX region. We are currently working on the 1987-91 plan to deploy equal access further in the most economical way, considering the needs of interexchange carriers and other NYNEX customers.

H. Challenges Raised

1. Non-Premium Discount

Notwithstanding these significant accomplishments, in the past several months a number of interexchange carriers have taken the stance that equal access as defined by the MFJ is not really equal. This is of importance because until equal access is implemented, all interexchange carriers other than AT&T receive a discount on the rates they pay NYNEX for access to our local networks. Specifically, some carriers are defining equal access to mean LATA-wide conversion of offices with access tandems in place. In addition, they are requesting the geographic clustering of these office conversions.

While we understand the marketing advantages of clustering conversions at this time, procedurally it is just not feasible. Much of the hardware and software necessary for converting an office is not transferrable between switching machines. Equipment ordered to convert one office usually cannot be used to convert a different office. In 1982, when the transition to equal access began, the priority was to develop a schedule which would allow for conversion to equal access according to the deadlines established by the MFJ. Offices were scheduled so as to maximize resources and minimize conversion time. The cutovers had to be scheduled one to two years into the future because of the lead time necessary for equal access hardware and software to be developed and manufactured for our switching systems. Orders had to be placed 12 to 18 months in advance, and because of the difference between switches conversion orders cannot now be appreciable rearranged.

LATA-wide conversion is not feasible because not all offices within a LATA will be converted to equal access by 1986, nor are they required to be by the MFJ. Many local switches are electro-mechanical rather than electronic or digital. Such switches are incapable of providing the equal access function (some small electronic offices also do not have this capability) and would have to be replaced in order for an office to be converted to equal access. To replace all these switches instantaneously would cost about \$3 billion dollars. Even if this capital could be raised at reasonable rates, and the actual work could be physically accomplished—neither of which is feasible—the adverse impact on our companies and customers would be enormous.

We strongly disagree with the position of those interexchange carriers who contend that access is not really "equal" unless it is provided on a LATA-wide basis with access tandems in place. NYNEX has addressed this issue substantively in comments filed with the FCC in Docket No. RM-5057. As discussed in those comments, some of the interexchange carriers have failed to recognize some of the facts. Let me clarify the record.

First, to whatever extent the LATA is not converted to equal access, the interexchange carriers continue to obtain a discount for those offices not yet converted. Moreover, these interexchange carriers do receive marketing and provisioning benefits out of an equal access end office whether or not the entire LATA is converted. The customers in that end office can use 1+ dialing, and the carrier, depending on the access it chooses to obtain, can terminate that call anywhere in the nation.

Second, the discount was intended only as a transitional mechanism. It is a link between the ability of customers to access all interexchange carriers in an equal manner and the charges paid by the carriers. The planned phase-out of the discount recognizes that the benefits of equal access increase as the level of conversions increase. Since the level of a carrier's payments for access depends on the mix of converted and nonconverted offices, these payments always reflect the relative level of equal access availability based on the percentage of access lines converted in the local calling area. Furthermore, the conversion of offices on a LATA-wide or other geographic basis was never contemplated when planning the scheduling of end office conversions. Inasmuch as these carriers are requesting a change in the ground rules at a point in the process when it is highly unlikely the rules can be changed, what they are really seeking is a perpetual discount.

In addition, the level of access charges paid by the interexchange carriers other than AT&T does not impact the overall access revenue requirement of the NYNEX Telephone Companies. Any shortfall resulting from the discount must be absorbed in rates paid by AT&T. This is an issue which is not of concern only for AT&T and the other interexchange carriers. It is important to NYNEX because while in the short term the NYNEX Telephone Companies remain "whole", there are long term implications. The difference in access cost to AT&T is a significant contributing factor to the incentive for AT&T to serve its customers by developing alternative facilities to the local exchange network.

The spiraling effects of increased costs of such bypass on the remaining users of the local exchange network have been well documented in FCC proceedings and reports. Any departure from the current plan to tie the elimination of the discount to equal access deployment will have significant economic effects on the NYNEX Telephone Companies' customers and would substantially reduce the value of equal access throughout the industry.

2. Access Tandem Schedule

Some interexchange carriers also have stated that when access tandems are not available prior to the conversion to equal access of the end offices subtending the tandem, they incur unnecessary inefficiencies and expenses. Access tandems collect traffic from a number of local offices before transporting the information to an interexchange carrier's point of presence. The NYNEX Telephone Companies have taken a number of actions to expedite the availability of access tandems. The creation of a tandem network is a major part of the NYNEX equal access plan. Currently, 11 access tandems are available in 8 NYNEX LATAs serving 92% of equal access local offices. Although, the availability of access tandems depended upon such factors as manpower resources and vendor deliveries, the NYNEX Telephone Companies responded to the carriers' concerns and installed access tandems in the New York and Greater Boston markets by March, 1985, which was as soon as possible. Our current implementation schedule through September 1, 1986 provides access tandem availability before 81% of all end offices potentially served by the tandems are converted to equal access.

III. PRESUBSCRIPTION

A. Overview

The second major issue that I would like to address is the equal access presubscription process. When equal access becomes technically and operationally available in a particular local office, a customer has the option of choosing an interexchange carrier to carry interLATA calls on a 1+ basis. The predesignated choice of an interexchange carrier for all 1+ calls is what we mean by the term "presubscription."

Availability of equal access has had a major impact on interexchange carriers. It has provided them with an enormous business opportunity. Presubscription is a key element of that opportunity. As a result, carriers have made concentrated efforts to get customers to presubscribe to their interLATA services.

NYNEX has always recognized the importance of presubscription to the success of equal access, and accordingly the maximization of presubscription has been a major objective of the NYNEX Telephone Companies. It is the maximization theme which is woven throughout the fabric of our presubscription program and which drives us to aid the interexchange carriers. NYNEX is committed to informing customers of the importance of their making their own choices, and the results of our efforts are encouraging.

B. Presubscription Results

When equal access first became available on September 1, 1984 in Back Bay, Boston, and West Street, New York City, 21,000 NYNEX customers were presubscribed to the interexchange carrier of their choice. On that date that represented 14.6% of all eligible telephone lines in the Boston office, and 27.5% in the New York office. As of July 1, 1985, those percentages had increased to 75% and 91% in Back Bay and West Street, respectively. The 11 offices converted in 1984 now have a combined presubscription rate of 55%, and this rate continues to increase.

Maximizing presubscription levels is one of several NYNEX objectives to insure complete satisfaction with equal access from the viewpoint of both the interexchange carriers and the end user customers. The other objectives include customer understanding; efficient, prompt, and high quality order processing; timely and accurate feedback to both customer and interexchange carrier regarding presubscription order processing; availability of comprehensive customer information services to interexchange carriers; and prompt resolution of problems with presubscription orders.

C. Process

The NYNEX presubscription process has evolved over time. We have made a number of changes since the NYNEX Presubscription Plan was filed with the Department of Justice in April, 1984. The changes have been made as a result of our continuing experience with the process, carriers' needs, and most recently, the FCC's decision on balloting and allocation of non-presubscribed customers. The current program, including enhancements already implemented and those scheduled in the near future, as well as the plan for implementing the FCC's order, are described below.

As part of our program, NYNEX notifies interexchange carriers at least nine months in advance of the schedule of a local office equal access conversion. At the same time, the carriers are provided with the volumes of originating and terminating long distance calls for each office, as well as the number of business and residence lines.

The NYNEX Telephone Companies also make customer information available to the interexchange carriers which identify each access line eligible for presubscription, together with the account information required for submitting an order. As a result of carrier requests, the NYNEX Telephone Companies make this same customer information available for all lines not yet presubscribed three months and again at six months after the date of conversion. The NYNEX Telephone Companies also provide interexchange carriers with a monthly list of their presubscribed customers. We also will soon provide carriers with account maintenance data and lists of their customers who have switched to another carrier.

Interexchange carriers opting to provide equal access service in a local office where conversion is scheduled to take place, first place orders for equal access facilities with the local NYNEX Telephone Company. Then once the order is placed, those carriers participate in the customer education and presubscription program that NYNEX has developed.

This program includes two mailings to customers advising them of the availability of equal access and listing the interexchange carriers that will offer service in that

office; two ways of placing a presubscription order either by contacting the selected interexchange carrier or by contacting the telephone company; and confirmation to both customers and interexchange carriers that the presubscription choice has been processed.

D. Ballot and Allocation

Despite the efforts of NYNEX and the interexchange carriers, some customers have not selected an interexchange carrier to handle their 1+ calls. To further encourage customers to presubscribe the NYNEX Telephone Companies were planning on implementing a procedure to send customers ballots and two trial operations involving the ballot were conducted.

On May 31, 1985, the FCC issued an order in CC Docket No. 83-1145 which required certain changes in the presubscription procedures for most of the telephone companies, including NYNEX. These changes became effective May 31, 1985 and apply to all customers who are served by local offices converting to equal access after that date. The NYNEX allocation plan, filed with the FCC on July 19, 1985, is designed to maximize presubscription levels before the allocation of non-responding customers.

The balloting and allocation plan applies to all local offices converted to equal access. There are three categories of such offices: (1) ongoing conversions starting December 21, 1985; (2) transition offices converted between the FCC order and December 21, 1985, the date of actual ballot/allocation implementation; and (3) offices converted before May 31, 1985.

1. *Ongoing Conversions.* In the ongoing plan, the initial customer notification, which will be mailed about ninety days prior to a local office conversion, must now include a ballot. Customers can indicate their choice of an interexchange carrier on the ballot and return it to the NYNEX Telephone Company in a pre-paid self-addressed envelope. They will be urged to make this selection within thirty days. This process will now give NYNEX customers three ways in which to submit presubscription orders to the NYNEX Telephone Companies: ballot, direct contact with the telephone company (a unique aspect of the NYNEX process), or direct contact with the selected interexchange carrier.

Thirty days after equal access becomes available in a local office, all customers who have not yet indicated their particular choice of an interexchange carrier will be assigned one from among the participating interexchange carriers. Non-presubscribed customers will be allocated to participating interchange carriers based on each interexchange carrier's percentage of the total presubscribed customers. These calculations will be done separately for business and residential customers. For example, if carrier "X" acquired 20% of the presubscription orders for residential lines and 40% of the business lines, then 20% of the residential lines in that local office which were not presubscribed would be allocated randomly to carrier X, as would be the 40% of the business lines which were not presubscribed.

Approximately 45 days after equal access becomes available, a second ballot will be sent to customers who have not presubscribed. This mailing will indicate to which interexchange carrier the customer has been tentatively assigned. Also, it will advise customers that if they do not wish their 1+ calls to be routed to that particular carrier, they must return the ballot (or otherwise place a presubscription order) within fifteen days. Within 75 days after equal access become available in a local office, all customers will be presubscribed, either to the interexchange carrier of their choice or the one to which they are allocated. Allocated customers will be given six months from the date of final allocation to make a free presubscription selection.

2. *Transition Plan.* For the transition period, covering offices converted to equal access after May 31, 1985, but prior to the full implementation of the ongoing plan on December 21, 1985, balloting and allocation will take place on a retroactive basis and a slightly modified schedule. In order to best meet the needs of the interexchange carriers, transition allocation will be accomplished by geographically clustering of equal access local offices whenever possible. Non-presubscribed customers will receive two ballots.

The first ballot will be mailed approximately 70 days prior to the selected date for the allocation calculation, and the second ballot approximately 15 days after the selected date. Final allocation of non-presubscribed customers will occur approximately 45 days after the selected date. Transition allocation will be based on each participating interexchange carrier's percentage of the total market share by end office as of the selected date. Thus, the allocation is calculated in the same manner as the ongoing plan. Allocated customers in transition local offices will be given six

months from the date of final allocation to make a presubscription selection at no charge.

3. *Pre-May 31, 1985, Equal Access Offices.* Nonpresubscribed customers in local offices converted to equal access prior to May 31, 1985 will be sent a ballot to encourage interexchange carrier selection. This retroactive balloting began September 1, 1985, and will be completed by June 1, 1986. This will be accomplished by geographically clustering equal access local offices wherever possible. During the retroactive balloting period, non-presubscribed customers may make one interexchange carrier selection free of charge until the six months subsequent to the mailing of the ballot. Interexchange carrier selection may be made by ballot, service center contact, or by direct contact with an interexchange carrier. Customers who do not presubscribe will remain with their existing interexchange carrier.

E. Overall Objectives

The NYNEX Telephone Companies have made every effort to both comply with the CC Order and accommodate the interexchange carrier's marketing needs. For example, the NYNEX Plan calls for allocation of non-presubscribed customers after conversion of the office to equal access, thus providing the interexchange carriers with the maximum amount of time to conduct their marketing efforts. Also, as mentioned above, we are providing reports to the interexchange carriers containing detailed customer information beyond that required in the order. We fully expect the ballot/allocation approach to become another effective method to foster the equal access objective.

IV. THE "COMPETITIVE" MARKETPLACE

A. Competitive Alternatives

The final point I would like to address is how NYNEX can and hopes to provide increased market opportunities for all interexchange carriers, while at the same time assuring the future business success of the NYNEX Telephone Companies. As I indicated at the outset, equal access has been and will continue to be a cornerstone of our post-divestiture business. With the successful implementation of equal access, the NYNEX Telephone Companies can provide an added dimension to the competitive structure of the interexchange carrier market through increased business opportunities for all carriers, local and interexchange.

Our NYNEX local exchange networks not only have the technological capability, but most importantly, our people possess the expertise to deliver and operate new and valuable services for large business customers at costs less than those customers would incur by utilizing the services now offered by our competitors or by constructing their own facilities. If NYNEX provides these services on an equal access basis, then as more customers are attracted, the NYNEX network becomes a valuable gateway between our local exchange customers and the services of all interexchange carriers.

Underlying the current restrictions on NYNEX business was the basic premise that the "competitive" areas of the telecommunications industry could be separated from the "natural monopoly" areas, with the interexchange carriers providing the competitive services and the NYNEX Telephone Companies providing the "monopoly" services under regulation. It was also assumed that equal access would make interexchange services "competitive", and this would develop vigorous and fair competition. The realities of the marketplace today, however, reveal that the NYNEX Telephone Companies do not possess a monopoly and that equal access alone, in today's restrictive environment, will not ensure a fully competitive telecommunications marketplace.

B. Examples

As the FCC has recognized, under current conditions AT&T and other interexchange carriers have both the "ability" and the "strong incentive" to compete with the local network by constructing and operating their own facilities or by connecting end user customers directly to the interexchange carrier's service using local private line facilities. With current technology, the cost of telecommunications facilities no longer constitutes a major barrier to entry into the interLATA access market. Interexchange carriers, particularly AT&T, are now also providing alternative local telephone networks for both large individual business customers and smaller business customers with shared facility arrangements.

Due to the high concentration of large business customers in New York and New England, NYNEX is probably among the first of the local exchange companies to face substantial competition for the provision of local telephone services and interLATA access to these large customers. For example, AT&T and Merrill Lynch re-

cently announced an agreement under which AT&T will provide facilities to connect Merrill Lynch's new headquarters in the World Financial Center directly to AT&T's existing transmission facilities in lower Manhattan, thus bypassing New York Telephone's local network.

This arrangement with Merrill Lynch is not the only evidence of competition. Recent filings by AT&T with the FCC regarding its Software Defined Network (SDN) and MEGACOM services demonstrate their competitive objectives quite clearly. These filings do not represent new service, but rather are pricing schemes that drive certain segments of the business population to bypass the local network without investing large sums of capital. AT&T and other interexchange carriers will continue to seek to provide service offerings based on alternatives to the local network. Both the SDN and MEGACOM services use AT&T's large No. 4 Electronic Switching Systems (ESS) to provide dial tone directly to customers, thereby eliminating the use of the local exchange companies public switched access network on the originating end.

There is every reason to believe that these arrangements and services are merely a portent of more to come. The technology is available, and the continued recovery from the interexchange carriers of non-traffic sensitive costs provides them with a significant economic incentive to avoid the local network. Thus, NYNEX expects that the interexchange carriers will continue to offer direct connection of large business customers to their interexchange networks.

C. Impact

The problem that the NYNEX Telephone Companies face from business customers avoiding the use of their facilities is potentially disastrous. For example, 35% of New York Telephone's business revenue is generated by its top 200 customers. Furthermore, more than half of these large business customers (124) are located in eight local offices south of Manhattan's 59th Street. The loss of all or a major portion of these high volume customers would have major adverse economic effects on the operations of the NYNEX Telephone Companies and their remaining customers. The fewer of these larger customers remaining on the network, the higher the portion of the fixed network costs each of the remaining customers will have to pay. These costs will remain even after customers are lost, and thus as the significant contribution formerly made by the larger customers towards these fixed costs will have to be recovered from the base of smaller customers.

In order to meet this competition, the NYNEX Telephone Companies must be able to offer services which are currently hampered or precluded by current unnecessary regulation. We believe current restrictions imposed by the MFJ and the FCC Computer Inquiry II rules are out of date and unnecessary, especially in highly competitive markets such as the New York City Metropolitan and Greater Boston areas where competition from by interexchange carriers and large business customers already exists. We thus commend the FCC's recent action instituting a rulemaking proceeding to re-examine the restrictions imposed by the FCC in Computer Inquiry II (CI-II). This proceeding, referred to as Computer Inquiry III, will address such issues as the need for structural separation, its impact on voice storage (Custom Calling ID), new routing and call setup capabilities proposed to be introduced in basic switched services (Virtual Network Services-VNS), protocol conversion, and the definition of "enhanced services" itself, all of which are subject to CI II regulations.

The requirements of CI II have prevented or hampered us from introducing new network services because structural separation prevents the integration of "enhanced services" with facilities for common carrier communications. This results in denial of the services to the public which cannot be efficiently and economically provided in a structurally separated environment. We welcome this opportunity to readdress CI II and seek the withdrawal of CI II restrictions to enable NYNEX to develop and offer to the public new and valuable competitive and enhanced services. These services will provide benefits to ratepayers by offering enriched network services.

The removal of the CI-II restrictions will also promote interexchange competition since an enriched local network will enable carriers to offer a greater variety of services. By using our enriched networks, smaller carriers will be able to compete with the one or few large carriers that have the resources to completely or selectively avoid our networks and install their own local switching networks.

Obviously, if NYNEX is not allowed to compete, we face the imminent loss of all or most of our large business customers. This would seriously threaten our ability to provide reasonably priced, and technologically current, high quality service to all our customers. If NYNEX cannot also provide value-added service using its avail-

able technological capabilities, then the larger customers will use alternatives to the local exchange networks. On the other hand, if NYNEX is allowed to respond competitively to those large business customers' needs, we are confident that we will be called on to provide service, thereby avoiding this potential shift in costs to the smaller local customers.

D. Opportunities for NYNEX and Interexchange Carriers.

The more equal access services that the interexchange carriers can obtain from NYNEX, the greater flexibility all interexchange carriers will have in developing and offering new services. For example, NYNEX construction of an equal access infrastructure permits interexchange carriers to access economically large business customers and selectively design and market their services.

It is our goal that the NYNEX Telephone Companies' networks will operate as access "gateways." This will enhance the competitiveness of the interexchange carriers and ensure an active role for the NYNEX Telephone Companies. Therefore, what NYNEX is suggesting is an extension of the concept of equal access. While not required by the MFJ as part of equal access, this would open the market further to competition. A description of three of the potential services which we can and should be able to provide follows:

1. *800 Access.* NYNEX is developing and plans to have available by 1988, 800 service access similar to AT&T's service which will enable customers to change interexchange carriers without changing their 800 numbers. As an outgrowth of 800 service, NYNEX also hopes to offer value added optional features to 800 service, such as time of day routing and multiple interexchange carrier access, which will assist carriers in serving niche markets and reducing the cost of carrier entry. We believe we are already permitted to provide those services. However, AT&T opposes our provision of this service. This matter is now being considered by the Department of Justice, and may ultimately become an issue before the Decree Court.

2. *Gateway Operator Services.* Gateway operator services, would allow NYNEX to offer interLATA carrier call assistance as well as credit-card, third number and/or collect calling services. Once the billed party's preferred carrier is identified, the NYNEX operator services system will function on behalf of the participating carrier, to verify, record and forward the call to the selected carrier's network. This service will provide the interexchange carriers the option of offering operator services, to their customers in direct competition with AT&T, yet avoid the need of investing large amounts of capital to set up their own duplicate operator system networks. AT&T opposes our provision of such access services to other carriers, and this matter is now also being reviewed by the Department of Justice.

3. *Virtual Network Service.* A Virtual Network Service (VNS) could provide customers with a cost-effective alternative either to private networks or extensive use of special service circuits. With VNS, all the customer's calls would be routed on the NYNEX Telephone Companies' public switched networks, using the software capabilities of their switching systems to replicate private networks. VNS extends the concept of equal access by providing more interexchange carriers with opportunities to serve the large business customer market.

We believe the services we propose to file are consistent with our nation's telecommunications policy. The additional services and expertise which NYNEX can offer is in keeping with the maintenance and advancement of our nation's telecommunications system. This past July, the National telecommunications and Information Administration, in its detailed report on national telecommunications, recognized the desirability of permitting the local exchange companies to provide their customers with a total communications package. The NTIA took the position that:

"There should be no restrictions on the Bell companies selling an overall package of any equipment and services to major customers as other firms such as AT&T and IMB now do. The ability to offer major users "one-stop shopping" is generally regarded as important to competing for these major accounts and the Bell companies should be given the opportunity to so compete." NTIA Report p. 44.

It must be recognized that full competition in the interLATA market cannot happen overnight. But we can take steps today to provide all interexchange carriers with the opportunity to compete on an equal access basis in markets which they select. All we seek is the opportunity to effectively use our existing assets to bring to the public the most advanced services available today—services which will continue to demonstrate this nation's leadership in the telecommunications field. These services will increase the uses and benefits of the existing network for all customers and interexchange carriers.

V. CONCLUSION

The issues being considered by the Committee are significant and have far-reaching impact on the nature of the telecommunications marketplace. I am grateful to the Committee for having been given the opportunity to present our view. There are four points that I would like to make briefly in conclusion:

First, NYNEX has been and continues to be totally committed to providing equal access in its service area and maximizing presubscription of interLATA service by its customers.

Second, while NYNEX has already made great strides in making equal access a reality in New York and New England, it remains willing and able to work with the interexchange carriers to continue to improve the conversion process.

Third, the FCC is deeply involved in the transition to equal access, and Congressional action is neither needed nor desirable.

Fourth, NYNEX must be relieved of any restraints that unjustifiably inhibit our ability to provide telecommunications services which meet customers' and interexchange carrier needs. This freedom will promote the national policy of competition in the telecommunications industry, and will ensure the continued availability of universal affordable telephone service.

Thank you.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR GOLDWATER AND THE ANSWERS

Question. Divestiture is only 20 months old. The transition to equal access, as you have testified, is an enormously complex and unprecedented task. Isn't it possible that when a telephone company office is upgraded to provide "equal access" that there are, at first, technical problems with the new connections?

Answer. Yes, it has been a complicated task. Nonetheless, from the technical vantage point, in terms of what is needed to be done with respect to the design and implementation of the necessary hardware and software, the process has gone exceedingly well. As with any software system problems will occur. We have, however, minimized these problems by performing extensive laboratory and filed tests on the switching equipment before it is deployed on a wide-spread basis. Furthermore, in the testing phase of the implementation of the switch, before equal access conversion, we have from time to time identified problems.

One such example involved a particular New York office where, during testing prior to conversion, it was discovered that intraLATA toll calls dialed as 10XXX + NXX + XXXX would not be completed by the switch. In this case, NYNEX alerted the switch manufacturer to the situation and experts from both New York Telephone and the manufacturer worked on the problem and within six days new software was written, installed and tested in the switch to allow for completion of 10XXX dialed interLATA calls. The cutover to Equal Access in that office was completed on schedule after the problem and been solved.

On the whole, the NYNEX Telephone Companies have not experienced any wide-spread technical problems with either equal access connections or with any problems that taken together establish a problems pattern. Rather, the relatively few technical problems, experienced thus far in the process have been isolated and have been quickly resolved.

Question. Once you have converted an office to equal access, do you provide the same quality connections to all long distance companies—AT&T and its competitors?

Answer. Yes the NYNEX Telephone Companies provide to all interexchange carriers connections that are of the same switching and transmission quality. As stated in the NYNEX Equal Access Plan (filed with the Department of Justice on April 4, 1984), the NYNEX Telephone Companies have developed a network plan whereby other interexchange carriers will be served by facilities which will produce switching and transmission of as good a quality as that provided to route AT&T interLATA calls.

The equal access service facilities for all carriers are selected from a common pool of available inter-office transmission facilities and the provisioning process is the same for all interexchange carriers. The facilities that directly link the interexchange carrier's location to the NYNEX local office are dedicated to the use of that carrier, and the provisioning of these facilities is accomplished by assigning available facilities to the carriers as requested.

In all cases, however, the facilities must meet all of the transmission design standards and pass all of the required pre-service tests. Also, during the testing phase that precedes placing the circuits into service, there is a common set of tests applied to all circuits to ensure that they meet "acceptance limits" for the various technical parameters. The transmission design specifications are the same for all long-distance companies, thus ensuring that each carrier receives the same quality of service. These specifications are referenced in our filed tariffs, and are plainly set forth in a series of technical references published by the Bell Communications Research technical staff.

Moreover, once a circuit is installed, if for any reason it ceases to function, NYNEX will work together with the particular interexchange carrier involved to get it back in service.

Question 3. MCI has recently stated to the Department of Justice that there are a number of problems with the customer subscription process. What are you doing to ensure that the subscription process works and to ensure that customers who sign up with a particular carrier are in fact connected to the selected carrier?

MCI STATED PROBLEMS

Answer. NYNEX is aware of the recent claims of MCI that there are problems with the presubscription process and has extended considerable effort in analyzing and understanding problems alleged by MCI. NYNEX has found that MCI's claims are generally exaggerations. Attached for your information is a copy of the NYNEX response to MCI's May 10 letter to the Department of Justice. We are also in the process of preparing a response to MCI's August 16 letter to the Department of Justice and will provide you with a copy as soon as it is completed. In general, MCI's second letter revisits the same issues without new data.

The Department of Justice is actively investigating a number of these issues and in that regard has established four criteria upon which to judge the Equal Access process. In this regard, I provided a certified statement to the Department on July 25, 1985 that the procedures implemented in NYNEX meet the specified criteria. I have attached a copy of my statement for your information.¹

ENSURE THE PRESUBSCRIPTION PROCESS WORKS

As I stated in my testimony, the process of implementing equal access is a tremendous undertaking in terms of labor, expense and capital investment, and has involved almost every department in the NYNEX Telephone Companies. NYNEX is committed, however, to provide equal access as quickly and as effectively as possible.

This commitment has been explicitly set forth in the detailed Equal Access Plan filed with the Department of Justice on April 4, 1985. The successful implementation of this plan is no less important to NYNEX than to its interexchange carriers. We consider a healthy, competitive long distance market place to be essential to our long term business goals.

It is clearly in our long term interest to keep as many people as possible on the NYNEX networks and to promote usage of that network. As equal access becomes more widespread, it will make our local access more valuable to both customers and carriers. The more choices a customer has, the greater the role the telephone company will play in the future of the telecommunications market.

It is also in NYNEX's best interest to ensure that the presubscription process works and that customers are correctly and promptly connected to the carrier of their choice. To the degree that we can satisfy our customers wishes we will be removing any desire on their part to connect directly to an interexchange carrier and bypass our networks.

To meet these goals, we developed a presubscription program which provides for the following activities:

- notification to interexchange carriers of scheduled local and office conversions, at least nine months in advance;
- provision of information regarding the volumes of originating and terminating interLATA calls for each office, as well as the number of business and residence lines;
- availability of information which identifies each access line eligible for presubscription, together with the account information required for submitting an order;

¹ The attachments are in the Committee files.

- availability of customer information for all lines not yet presubscribed three months and again at six months after the date of conversion;
- availability to interexchange carriers of a monthly list of their presubscribed customers;
- two mailings to customers advising them of the availability of equal access and listing the interexchange carriers that will offer service in their office;
- two ways of placing a presubscription order, either by contacting the selected interexchange carrier or by contacting the telephone company; and
- confirmation to both customer and interexchange carrier that the customer's presubscription choice has been processed.

NYNEX is developing a completely new internal processing system for implementing the FCC's recent order prescribing the allocation of non-presubscribed customers. On July 19, 1985, NYNEX filed its Allocation Plan with the FCC. This plan is designed to maximize presubscription levels before allocation of non-responding customers. The plan also provides for ease of customer choice by providing for customer requests to flow to the telephone companies through either interexchange carrier orders, ballots or a direct customer call to our service centers.

Both the current presubscription plan and the allocation plan were designed to result in a process that would work effectively and that would ensure that a customer would be efficiently connected to the carrier of his or her own choosing.

NYNEX has ensured that the process works through the commitment and dedication of huge quantities of resources to effect presubscription. NYNEX has also ensured that the process works by seeking feedback from the interexchange carriers. NYNEX has and will continue to meet with the interexchange carriers to make the process work. As I stated in my testimony, we have held four NYNEX conferences with the interexchange carriers in the past thirteen months. In addition we have met individually with carriers, including MCI, as necessary and as requested. I have been personally involved in many such meetings. We remain willing to meet with any carrier as the need arises to resolve particular difficulties.

And we participate in national fora; for example, the Interexchange Carrier Compatibility Forum, the National Operations Forum, and the Ordering and Billing Forum. We conduct one on one planning and conversion meetings with individual carriers. We have also given the interexchange carriers training on order placements. Thus, NYNEX and the interexchange have worked and shall continue working together to make equal access and the presubscription process a success in the states in which we operate.

One of the additional methods that NYNEX has used to ensure that the presubscription process functions correctly is accountability. In its Equal Access Plan, NYNEX designated specific executive level officers, including myself, to assume the responsibility to oversee the planning and implementation of the conversion of its offices as well as the entire presubscription process.

The NYNEX Equal Access Officers review policy matters and the status of the process on a weekly basis at a minimum, and currently meet monthly in full day formal review sessions. We feel that this approach provides a vehicle to coordinate all marketing as well as provisioning activities while also providing tight controls.

ENSURE CUSTOMER CONNECTED TO SELECTED CARRIER

The NYNEX presubscription process is designed to ensure that customers who sign up for a particular carrier are in fact connected to their selected carrier. Toward that end, NYNEX has committed extensive resources to develop mechanized systems to handle the complex tasks involved in the presubscription process.

New administrative systems relating to receiving, processing and completing presubscription orders have been developed and implemented. All of these systems have been developed with generally accepted internal controls to ensure that all orders are accounted for and are properly handled. In those situations where a portion of the process must be handled on a manual basis, administrative procedures have been instituted that have quality and accuracy as the first objective.

NYNEX has as a goal the mechanized handling of a maximum percentage of presubscription orders. This goal provides the triple benefits of reducing human error, shortening the completion interval and reducing costs.

NYNEX has always provided carriers with timely notification of accepted orders after the processing of that order has been completed. This provides an opportunity for the carrier to notify the telephone company if that order has been incorrectly processed.

The NYNEX companies also provide a great deal of additional notification to the carriers beyond accepted orders including orders that have been found to have

errors, orders that have been processed, orders that could not be worked due to a conflict, and notice that a carrier's order for a customer has been displaced by a subsequent valid order. My statement to the Department of Justice dated July 25, 1985, which I mentioned earlier, discusses this in greater detail.

In addition to the notifications provided to the carriers, NYNEX also notifies the end user customer that a presubscription order for the identified telephone lines has been completed. This positive notification informs the end user that he or she has been presubscribed to a particular carrier. This notification is sent to the customer regardless of whether the order to the telephone company was initiated with the telephone company directly by the customer or through a carrier. This provides a direct opportunity for the end user to determine whether we have correctly implemented his or her connection to the selected carrier.

NYNEX has verified the process by conducting reviews and audits of this process. One of the methods used to ensure the process is a comparison of the record of the customer's presubscription choice as reflected in our Customers Record Information System (CRIS) billing system with that customer's connection (translation) in our Electronic Switching Systems (ESS). These comparisons are referred to as ESS/CRIS reconciliations.

For example, in a recent ESS/CRIS reconciliation performed by New England Telephone, the results demonstrated that the success rate for the implementation of presubscription choices is very high. The ESS/CRIS reconciliation in New England was completed in mid August and covered 32 of the initial equal access offices revealing an error rate of less than .6%.

In addition, NYNEX was asked by the Department of Justice to conduct an audit of 5% of its equal access end offices to evaluate (1) "the process of implementing presubscription orders including both the service order form and the switch performance after cutover" and (2) "whether customers using a presubscribed carrier or the 10XXX code of a carrier are getting routed to that carrier". The results of the review that NYNEX conducted in response to this request demonstrated that the error rates involved in both these cases were very low. A copy of the relevant portions (information considered proprietary has not been included) of the NYNEX response to the Department of Justice is provided for your information.

Moreover, NYNEX has taken a proactive role in ensuring that the process is working. In addition to monitoring the results of the process through reviews like the ESS/CRIS reconciliation described above, NYNEX has been responsive to problems that have occurred as well as innovative in developing techniques to improve the process.

NYNEX has taken advantage of the opportunity that each of the above reviews creates to scrutinize its methods and procedures. In all cases where a review has indicated that an improvement was warranted, NYNEX has expeditiously formulated procedural changes or enhancements to mechanized systems.

NYNEX has also developed an innovative technique that will provide a timely analysis and identification of customers presubscribed to an incorrect carrier in the ESS switch as well as customer calls that route to an incorrect carrier despite being correctly presubscribed in the ESS switch. This technique as developed by NYNEX involves a computer analysis of every call carried through our network to a carrier.

In summary, NYNEX has taken considerable time, effort and resources to ensure that a customer is connected to the carrier he has selected. NYNEX has dedicated considerable resources in designing and developing processes that have adequate controls. All of the NYNEX processes have been tested and reviewed to ensure that presubscription works for both customers and interexchange carriers.

Question. Do you consider the availability of upgraded "Feature Group D" facilities to be "equal access?"

Answer. Yes, we do. The Modified Final Judgment (MFJ) mandates that equal access service be made available to all interchange carriers so that their customers may place interexchange calls on the 1+ dialing basis. The MFJ further requires that access be provided to allow customer designation of a different interexchange carrier by dialing a minimum number of additional digits. A customer served by a carrier which subscribes to our Feature Group D service has that ability. He or she can dial 1+ the area code + the 7-digit number and have his or her call automatically go over the lines of the carrier chosen by the customer. In addition, by dialing the appropriate five-digit access code the customer can select another carrier to handle that particular call.

Our Feature Group D service also offers additional optional enhancements such as a per call identification of the calling party (ANI), separation of the calls onto different trunk groups by originating class of service or call type (1+ dialed versus

0+ dialed or 800 SAC), and tandem access routing. These options allow the carriers to provide services comparable to those that AT&T provided prior to divestiture.

Senator GOLDWATER. Our next witness is Mr. Ackerman.

Mr. ACKERMAN. Mr. Chairman, I am Duane Ackerman, executive vice president representing BellSouth, Southern Bell, and South Central Bell. I appreciate the opportunity to share our views with you today.

As the other local telephone companies have testified we at BellSouth have also done a good job providing equal access to the other common carriers. Not only have we met the requirements of the MFJ, but we have also been working with the OCC's to satisfy other needs and to improve the many billing and ordering procedures that are necessary during this transition.

Against a target of 33 percent by September 1, 1985, BellSouth has converted 7.7 million access lines, or 54 percent of our lines today. We are cutting an average of 20,000 lines a day to equal access. In testimony last week, one of the OCC witnesses testified that access was improved but not equal, and several reasons were cited.

There was a reference to a lack of tandems which would increase their cost. In the 9 Southeastern States, BellSouth will have 64 tandems in its 38 LATA's.

There was a reference to inadequate notices being supplied on offices to be cut. BellSouth publishes its cutover schedule well in advance with a firm schedule 6 months in advance.

There were also charges that the conversions are scattered. Today more than 75 percent of the access lines in our 11 largest metropolitan areas have already been cut to equal access. There are over 5 million lines in those 11 cities, and one can certainly use radio or TV to address that type of market.

We also wanted to make the point today that there are a number of industrywide forums other than Congress and the FCC working on improving the transition to equal access. There are four separate industrial forums. There is a technical forum; there is a testing and operational forum; there is an ordering and billing forums. All are working under the umbrella of a carrier liaison committee. In addition to that, there are individual company interfaces which work on specific business problems.

In addition, we have the FCC, the Department of Justice, and the State commissions all involved in completing the transition to equal access, and we believe these interfaces are sufficient to do the job. If there is a need for further action, before that action is taken we believe the subcommittee should take a look at a broader array of competitive issues.

At last week's hearings, Chairman Goldwater, Senator Gore and others raised the issue of the impact of the FCC's rules and the MFJ on the ability of U.S. companies to compete at home and abroad. They also expressed concern about the impact of domestic telecommunications policy on telephone consumers.

These intertwined relationships require a careful examination of what the impact of any decision would be on other forms of competition throughout the industry. For example, the issue of market power has been raised several times in these hearings.

We, too, are concerned about market power, especially that exhibited by ATTIS-ATTCOM and IBM-MCI-ROLM. These full service providers will not only be competing for each other's traditional markets, but they will also be competing for revenues that are currently being used to support the local public switched networks. In BellSouth 2 percent of the large business users are responsible for 40 percent of the access charges and other business revenues, and BellSouth must be able to compete for these large business revenues if we are to continue to meet the needs of all of our residence, small business and rural customers.

The FCC's restrictions against joint marketing of basic service, enhanced service and customer premises equipment places BellSouth under a handicap when competing with full service providers, especially at a time when, as the consumer representative testified last week, customers demand one-stop shopping.

We hope that the FCC will move quickly to remove these restrictions in their CI-III proceedings. There are also MFJ restrictions that should be relaxed, especially where the so-called bottleneck no longer exists, such as in certain segments of the large business market, geographical territories outside operating company exchanges, and in foreign markets.

In summary, BellSouth is in compliance with the equal access obligations as required by the U.S. district court. We, therefore, propose that the equal access transition plan be allowed to move forward and that the OCC's discount be eliminated when equal access is implemented in each end office.

Thank you, Mr. Chairman.

[The statement follows:]

STATEMENT OF F. DUANE ACKERMAN, EXECUTIVE VICE PRESIDENT FOR MARKETING, NETWORK, AND PLANNING, BELL SOUTH SERVICES INC.

I. INTRODUCTION

This statement on behalf of the BellSouth Corporation and its Operating Telephone Companies, Southern Bell and South Central Bell, is being filed with the Subcommittee on Communications of the Senate Committee on Commerce, Science and Transportation in connection with its hearings concerning telecommunications competition in long distance markets, September 5 and 11, 1985. The statement is intended to provide additional detail and insight into the issues considered by the Subcommittee beyond that which is practicable in a brief oral summary provided by F. Duane Ackerman, Executive Vice President, BellSouth Services, Inc., who is BellSouth's witness in these hearings. BellSouth appreciates the opportunity to share its views on this matter with Members of the Committee.

II. THE BELL SOUTH CORPORATION AND ITS SUBSIDIARIES

The BellSouth Corporation is one of seven regional companies formed from the divestiture of the American Telephone and Telegraph Company (AT&T). At inception, its 13.6 million access lines and \$21.5 billion in assets made it the largest of the regional companies. Forty-six million people make their home in the BellSouth nine state region and its population is growing 40 to 50 percent faster than the U.S. average. BellSouth's major responsibility is to provide local telephone service to its customers.

The BellSouth Corporation has three principal subsidiaries which are directly involved in the provision of local exchange telephone service. Southern Bell is the Operating Telephone Company which serves the states of North Carolina, South Carolina, Georgia and Florida. At year end 1984, Southern Bell served approximately 7.8 million access lines. South Central Bell is the other Operating Telephone Company and serves the states of Kentucky, Tennessee, Alabama, Mississippi and Louisiana. At year end 1984, South Central Bell had approximately 6.3 million access lines.

BellSouth Services is a region-wide organization owned jointly by Southern Bell and South Central Bell. Its purpose is to control the cost of service by eliminating duplication and providing professional, centralized services in network strategic planning, materials management and procurement, information systems and marketing support.

The BellSouth Corporation also has created a number of subsidiaries in order to meet telecommunications related demands. BellSouth Mobility, Inc. is our cellular subsidiary which already operates 11 systems; Birmingham is scheduled to become operational this month. BellSouth Advanced Systems, Inc. is our equipment sales subsidiary; BellSouth Systems Technology is our shared tenant services operation; and, BellSouth International is exploring opportunities to share our telecommunications expertise with foreign partners. BellSouth Advertising and Publishing Corporation sells Yellow Pages advertising and publishes and distributes over 500 telephone and special directories for the two BellSouth operating telephone companies and other telephone companies in the Southeast.

Technology is helping to control costs and improve service in the telecommunications field and the critical aspect of any telephone network is its switching system. BellSouth has a very modern, flexible switching system which provides state-of-the-art technology to its customers. The electronic switching system, ESS, now dominates the switching capabilities of both Southern Bell and South Central Bell, serving more than two-thirds of their customers. ESS offices are reliable, versatile, and efficient and they make possible a variety of custom calling services which facilitate our customers' use of the telephone network.

The BellSouth Operating Companies also are participating in the transition from analog to digital networks. Digital networks require no signal conversion for transmission of data signals and they transport information in the same way it is generated by computers. In addition, they do it faster and more efficiently. With digital technology, not only are voice and data transmission more flexible, the two also can be transmitted simultaneously using packet switching.

In addition to focusing on the continued improvement of its switching systems, BellSouth is deploying new technology in its network distribution systems as well. This is being done through the introduction of fiber optic cable. Both Operating Companies are making use of this new technology which is less expensive per circuit, less susceptible to maintenance problems, and impervious to electrical interference and lightning damage.

We are keenly aware that excellent service at affordable rates are criteria by which our customers evaluate our performance. But in the rapidly emerging competitive telecommunications marketplace, we know too that customers expect technological innovation in the services available to them. For that reason, BellSouth is committed to introducing new services that improve the quality of life for residence and business customers alike. For example, this year we are participating in a test of a system in Atlanta that uses TranstexT[™], an advanced in-home communications system to let customers easily and economically control utility usage and enjoy a wide range of useful services including home banking, electronic shopping, personal security, news and education services—all possible with a Touch-Tone telephone and a standard television set.

Public policy has dictated major changes in the structure of the domestic telecommunications industry. These changes will have a profound impact on customers and the services provided to them for years to come. At BellSouth we are committed to making the necessary transition process as smooth as possible for all of our customers. And we are equally committed to participating fully in the new marketplace so the benefits of competition (innovation and a full range of choice in service and price) are readily available to our customers. Thus despite the sweeping nature of the changes in our business, one critical aspect has not changed for the BellSouth Companies . . . our dedication to the "spirit of service."

III. THE FEDERAL COMMUNICATIONS COMMISSION'S EQUAL ACCESS TRANSITION PLAN IS WORKING WELL AND STEADY PROGRESS IS BEING MADE TOWARD A FULLY COMPETITIVE INTEREXCHANGE MARKET

The BellSouth Companies are fully committed to meeting their equal access obligations prescribed by the MFJ. Southern Bell and South Central Bell not only have met their end office conversion obligations to date, they have exceeded them. In addition, the Companies have taken the initiative to provide tandems and to cluster end office conversions in major metropolitan areas. Four industry-wide forums which were established to address the administrative processes required for implementing equal access have been working well to resolve problems as they arise. For

these reasons, BellSouth believes that the transition to equal access is on (and in some cases, ahead of) schedule and is proceeding smoothly. Changes in the transition plan therefore are unnecessary.

A. The Modification of final judgment has imposed specific equal access obligations on the former Bell Operating Companies

The equal access provision of the MFJ requires the Bell Operating Companies to provide all interexchange carriers and information service providers exchange access and information access services on a disaggregated tariffed basis, that is equal in type, quality, and price to that provided to AT&T and its affiliates.

The parameters and timetable for the provision of equal access are specific and detailed. For example, Appendix B of the MFJ states that Operating Companies must begin providing "equal access" no later than September 1, 1984, equal access must be available through end offices servicing at least one-third of a BOC's exchange access lines by September 1, 1985, and upon a bona fide request, every end office must offer such access by September 1, 1986. Additionally, if a BOC offers exchange access to an interexchange carrier that is not equal in type and quality to that provided AT&T, the Operating Company must file a tariff to reflect the lesser cost, if any, for such access as compared to the access provided AT&T.

In addition to the definitions of equal access and the more technical distinctions set forth in the MFJ, there is a provision regarding non-conforming offices: end offices employing switches technologically antecedent to electronic stored program control switches and those that characteristically serve fewer than 10,000 access lines. An Operating Company may not be required to provide equal access in these offices, if, upon receipt of a bona fide request, the Operating Company demonstrates to the court that such access is not physically feasible except at costs that clearly outweigh the benefits to the users of telecommunications services.

As late as June 25, 1985, the Department of Justice advocated four new administrative practices which it deems essential for fulfilling the BOCs' equal access obligations under the MFJ. Basically, the practices relate to providing certain information to, and mechanizing certain interfaces for, interexchange carriers with respect to the presubscription ordering and conversion process.

BellSouth stated in its reply that while it already had practices that equal or exceed the Department's practices, it disagrees with the Department's contention that these are required either under the MFJ or under the FCC's allocation order which was approved on May 31, 1985. BellSouth further stated that the MFJ treats equal access as a network phenomenon, measuring compliance in terms of access lines converted under a specific schedule, and in terms of quality and cost of access available to the OCCs as compared to AT&T.

The mechanics of equal access implementation require complex, technical and detailed resolution by subject matter experts. As discussed in detail later, the national forums established by the industry to deal with equal access implementation are working well and are providing a common ground on which all carriers can meet to discuss their individual concerns. Through these organizations, we are working with all carriers in the industry to improve any administrative steps that are reasonable and helpful to the industry.

Subsection B, which follows, provides substantial evidence of BellSouth's ongoing commitment to meeting its equal access obligations.

B. BellSouth has not only met its equal access obligations to date, it has exceeded them

As noted above, the Modification of Final Judgment requires the Regional Holding Companies to provide equal access to all interexchange carriers. In order to implement equal access, telephone subscribers were given the opportunity to pre-select a preferred carrier for interLATA calling. Both Southern Bell and South Central Bell expended considerable effort to develop procedures that would be responsive to the diverse needs of subscribers and carriers, while at the same time being implementable without disrupting our obligations to provide local exchange service.

In developing our conversion schedule and notification methods and procedures, the following points were of primary concern:

- compliance with all judicial and regulatory requirements
- equitable treatment for all carriers

presentation of equal access material to our subscribers that would ensure maximum readership and comprehension while encouraging them to deal directly with interexchange carriers.

In developing the conversion schedule, the BellSouth Companies believed that the OCCs would be most interested in obtaining equal access in offices where they were

being served by ENFIA A and ENFIA B type arrangements. Experience has confirmed that we were correct to take this approach. Many features of the Companies' conversion plans were based on the fact that existing OCC arrangements were predominantly in the major metropolitan areas with high volumes of interLATA traffic.

In addition to taking into account OCC concerns and preferences, the BellSouth Companies also had to consider the effect of the conversion on their customers who depend on high quality, day-to-day local exchange service. To implement equal access efficiently, the conversion plans were incorporated into the existing Operating Companies' construction budgets. By so doing, work loads were leveled enabling the Companies to meet MFJ and OCC requirements in a cost effective manner while at the same time continuing to meet the public's ongoing local exchange telecommunications requirements.

The equal access conversion schedule also was affected by the limited availability of the necessary equipment and software generics. Such constraints arose because equal access was being implemented nationwide and simultaneously by all the divested Operating Companies. Accordingly, the initial conversion schedule focused on converting end offices equipped with 1ESS and 1AESS equipment because such conversions could be accomplished quickly and to the benefit of the OCCs.

During calendar year 1985, the BellSouth Companies will convert on average more than one end office per day, seven days a week. The average size of offices being converted is 19,500 access lines. And to the extent possible, end offices in the same areas are being converted at the same time. By September 1, 1985, about 54 percent of all access lines were converted to equal access. And by December 31, 1985, about 62 percent of all access lines within the BellSouth Region will be served from offices that have been converted to equal access offices will be even greater. In these areas, 76 percent of access lines will be served by equal access end offices. For 11 of the largest metropolitan areas in the BellSouth Region, 83 percent of the lines will have equal access by year end.

This evidence affirms that BellSouth is well ahead of schedule for meeting its equal access obligation. It also demonstrates that in planning the conversion, the Companies attempted to harmonize their responsibilities to their customers with the needs of the OCCs. For example, BellSouth's balloting plan is designed to permit OCCs to take maximum advantage of mass media advertising by clustering conversions that generally coincide with defined television markets or areas of dominant influence (ADI).

The herculean task of implementing equal access is being accomplished ahead of schedule; in addition, the accuracy rate for order implementation meets high standards as well. For example, in response to a recent Justice Department request for a special audit regarding equal access implementation, BellSouth found that the accuracy rate for order implementation was over 98 percent.

Despite the efforts expended to date and the results achieved, BellSouth recognizes that the task is not over and that further effort is still required to work out unexpected or unusual problems. In most cases these problems require industry-wide attention.

To deal with these implementation matters four national groups have been established: the Interexchange Carrier Compatibility Forum, the Network Operations Forum, the Ordering and Billing Forum and the Carrier Liaison Committee. The last group serves as the umbrella appeals group for the other three. These forums are fully capable of dealing with any issues that may arise during the transition to equal access and have been successful to date in resolving a large number of administrative and technical problems.

In summary, despite the challenges posed by equal access implementation, significant progress has been made and the mechanisms to deal with unforeseen developments are in place. Thus any major alteration to the transition plan is totally unwarranted and would be disruptive.

c. BellSouth has introduced adjustments and refinements to the transition plan resulting from experience gained by BellSouth and the OCC's during early stages of conversion

As BellSouth developed its conversion plan, and as discussions developed with the OCCs, it became obvious that mutual cooperation would be the key to a successful transition. The BellSouth Companies recognize the importance of the role of equal access in the FCC's pro-competitive policies and the need to implement equal access in a manner that maximizes the utility of equal access to interexchange carries. As will be discussed in detail later in this statement, there is a vital link between a

fully competitive interexchange market and high quality, affordable local exchange service.

The BellSouth Companies, for their 1986 end office conversions, will cluster the conversion of end offices in 11 of their largest metropolitan areas. In addition, in order to maximize the utility of such conversions, all conversions in cities with one cluster period will be completed within a six to eight week time frame from the commencement of the conversion process.

The purpose of this refinement is to help the OCCs take full advantage of the conversions through concerted marketing and advertising. By so doing, customers in each area will be able to choose the interexchange carrier to suit his or her requirements. Thus, customers will be afforded an opportunity to take full advantage of a competitive marketplace. BellSouth believes that by better meeting customer requirements, demand for service is likely to increase. Such a result will benefit long distance customers, interexchange carriers and the BellSouth Companies as well.

Table 1 shows the BellSouth cluster schedule. As the data demonstrate, certain large metropolitan areas have two cluster periods.

TABLE 1.—BELLSOUTH CLUSTER SCHEDULE

Metro area	Start date	Complete date
Nashville ¹	01/06/86	01/27/86
Atlanta ¹	01/20/86	03/03/86
New Orleans	05/19/86	06/30/86
Miami and Ft. Lauderdale ¹	05/19/86	05/26/86
Birmingham	06/09/86	07/21/86
Raleigh	06/23/86	07/28/86
Louisville	06/30/86	08/25/86
Atlanta ¹	07/28/86	09/01/86
Memphis	08/18/86	08/18/86
Miami and Ft. Lauderdale ¹	10/20/86	11/17/86
Nashville ¹	08/25/86	10/27/86
Jacksonville	10/20/86	12/01/86
West Palm Beach	11/10/86	11/10/86

¹ Two cluster periods.

Table 2 shows the access lines for each of the clustered metropolitan areas.

TABLE 2.—Access lines in metropolitan cluster areas

Metro area:	Access lines
Birmingham	341,940
Louisville	315,262
New Orleans	550,735
Memphis	377,746
Nashville	311,674
Miami and Ft. Lauderdale	1,522,934
Jacksonville	323,551
West Palm Beach	288,442
Atlanta	1,256,091
Raleigh	165,630
Total	5,454,005

This total represents 39 percent of the BellSouth Operating Companies' access lines.

D. BellSouth has developed a presubscription process that will maximize consumer choice and meet OCC needs

The purpose of presubscription is to make certain that customers have accurate information concerning their choices of interexchange carriers as equal access is implemented. Despite the publicity since divestiture, many customers still do not understand that different, independent companies provide their local and long distance services. This can make presubscription a complex and evolutionary process for the companies and for customers.

Prior to equal access conversion of an end office, subscribers served by that office are sent information about the carriers serving their end office and about proce-

dures for long distance calling. They also are sent ballots both before and after conversion to encourage voluntary selection of a primary long distance carrier.

Many customers whose end offices were converted to equal access between August 1984 and August 1985 did not presubscribe to a primary carrier. They will be given another opportunity to select an interexchange carrier by ballot between September 1985 and February 1986. This selection process should meet OCC needs since it is being conducted on a tandem area basis.

BellSouth's efforts to distribute customer ballots in a given metropolitan area over a relatively short period of time should enable interexchange carriers to make more efficient use of mass media advertising regarding availability of their equal access services. This is especially true throughout the nine state BellSouth region because BellSouth's balloting plans for individual metropolitan areas generally coincide with defined television markets or areas of dominant influence (ADI). BellSouth acknowledged this need and developed its balloting plans in accordance with what would make the most sense from the OCCs' point of view. This is an example of a problem that was resolved through cooperation between all parties.

In addition to notifying subscribers that equal access is available, the BellSouth Companies provide the following lists to interexchange carriers:

- a list of presubscribed customers prior to the equal access availability date;
- a list of non-presubscribed customers after the equal access availability date;
- and
- a list of specific carrier's presubscribed customers after the equal access availability date.

The customer lists contain the name, address, main telephone number by account, and business or residential classification. In the BellSouth region, customer lists may be ordered on a demand basis or on a recurring basis. Charges for each list consist of a set-up fee plus the per record charge times the number of records. The BellSouth Companies make these lists available as paper output, standard mailing labels, mag tape, or fiche. Where mag tape is requested, tapes are provided in the standard IBM format.

A number of adjustments have been introduced during the implementation process. For example, eighteen months ago MCI suggested to its BellSouth account representative that certain presubscription information be mechanized and suggested a format. Within the next four months, BellSouth received requests from three carriers (including MCI) to enhance or modify the presubscription ordering process. Several meetings were held to discuss these requests to assure mutual understanding of the interexchange carriers' needs.

BellSouth organized a project planning team to work out the details of mechanization. At the same time, however, other Operating Companies also were meeting with interexchange companies to work out plans for other regions. It became apparent to all parties that a national standard was needed, and in April 1985, a joint Operating Company/interexchange carrier body, known as the Network Operations Forum, issued approved standards.

The BellSouth Companies began to furnish reports in the agreed upon standard format in August 1985. On September 28, 1985, BellSouth will be prepared to receive mechanized input in the Network Operation Forum's standard format from the interexchange carrier industry. Although all interexchange carriers may not be ready to operate in this standard interface manner by this time, the BellSouth plan allows for presubscription orders to be submitted as they are today until such time as the carriers can adapt to the national interface standards. It is important to understand that the industry strongly favored implementing mechanization as soon as possible, but it is necessary to provide flexibility in our implementation plans so that all interexchange carriers can be accommodated.

Prior to these efforts, BellSouth already had made provisions for mechanization input of interexchange carrier orders. This was done while awaiting the outcome of discussions concerning a national standard in order to minimize whatever delay might be associated with converting to mechanization. Last February, the BellSouth Companies developed a revised presubscription process that provided interexchange companies with the option of placing presubscription orders using the mechanized interface. On March 15, 1985, this magnetic tape order submission option was implemented.

Last April, MCI submitted its first magnetic tape to South Central Bell, followed by a tape to Southern Bell in May. The following companies are submitting at least some of their orders on magnetic tape to the BellSouth Companies: MCI, ATT-C, Teltec, U.S. Telecom, Allnet, USTS, Telecommunications Systems, TransCall America and TDX Systems Incorporated.

These examples of cooperation between the local Operating Companies and the interexchange carriers demonstrate that the FCC's equal access transition plan is working smoothly and that adjustments and refinements can be agreed upon and implemented by all participants, as needed. This is not a static undertaking, but rather an evolving process in which normal operational problems emerge on a day-to-day basis and solutions are developed.

These examples also underscore the fact that no one company or group can be held accountable for the success or failure of the plan. The key to the plan's success is mutual cooperation. The industry is doing its best to make certain that the procedures utilized benefit all involved, local and long distance carriers as well as customers. Four national forums provide environments in which to address problems resulting from presubscription. BellSouth believes that these groups have been successful in providing a common ground for all carriers.

E. As further evidence of BellSouth's intentions, access tandems have been made available to interexchange carriers

In connection with discussions about the adequacy of the FCC's equal access transition plan, the OCCs have stated that the equal access made available to them is not on a par with the access made available to AT&T because access tandems are not in place. The OCCs have stated that the absence of access tandems would increase their costs and complicate their facilities planning. The BellSouth Companies already had decided to make access tandems available to the OCCs as part of the conversion to equal access prior to these assertions.

As shown in the following table, by September 1, 1985, nearly 80 percent of all access lines converted to equal access in the BellSouth region were served from end offices which subtend in access tandem. By the end of 1985, the percent of such access lines will increase to 96 percent. In those instances where an OCC Feature Group D (FGD) trunk is provided through an access tandem, the OCC will have FGD terminating access available to all subtending end offices in the tandem area, regardless of whether the subtending end office has been converted to equal access. Thus, BellSouth's efforts in this area have anticipated, and been fully responsive to, OCC needs.

TABLE 3.—AVAILABILITY OF ACCESS TANDEMS IN THE BELL SOUTH REGION

[In percent]

	Sept. 9, 1985	Dec. 31, 1985	Sept. 1, 1986
Number E.A lines served by tandems (region).....	78.5	96.5	100
Number E.A lines served by tandems in major metro areas (50,000+).....	81.5	98.2	100
Number E.A lines served by tandems in 11 largest major metro areas.....	85.6	100	100

In addition to providing access tandems, BellSouth would like to make a number of additional services available to the OCCs that would make them more competitive with AT&T. These include: 800 Service, operator assistance, billing service, intraLATA transmission service and card reader public telephone service. While BellSouth's interest in providing these services is based primarily on generating sound revenue streams, they also will have the effect of putting the OCCs' customers on an equal footing with AT&T's customers.

In evaluating OCC claims about the value of equal access provided to them, it is important that issues such as the availability of access tandems be reviewed on a region-by-region basis. Although it may be appropriate to review the status of the FCC's equal access transition plan on a nationwide basis, it is essential that differences between companies, states, and regions be taken into account. This is not to suggest that some companies are less committed to the plan's successful implementation than others, but region specific characteristics do affect the rate of progress being made. BellSouth has devised and implemented its plan taking several factors into account: characteristics of its region in terms of residence and business customer needs; volume and concentration of interLATA calling; relative cost and difficulty of end office conversions; requirements of the OCCs; and, impact of implementing the plan on the Operating Companies' construction budgets.

A review of equal access implementation in BellSouth's nine states will demonstrate that end office conversions have exceeded MFJ obligation; that customers have been provided with ample opportunity to select a preferred interexchange carrier; and, that access tandems have been provided throughout the region to help the

OCCs compete more effectively. BellSouth has conscientiously pursued these goals because it believes they are necessary steps toward a fully and workably competitive telecommunications market.

IV. THE OCCS' CLAIM THAT REMOVING THE DISCOUNT WILL THREATEN THEIR FINANCIAL VIABILITY AND ELIMINATE COMPETITION IN THE LONG DISTANCE MARKET IS OPEN TO QUESTION

The Booz, Allen & Hamilton (BAH) study submitted to the FCC by GTE Sprint states that the major facilities-based other common carrier (MFBCs) will earn an inadequate rate of return for the rest of the decade. From the Booz, Allen analysis GTE has concluded therefore, that "the prospects for effective competition in the long distance market are in severe jeopardy." Both the analysis and its interpretation are open to question since factors other than access costs may well play a role in cost differences between these carriers and the dominant carrier, AT&T. In addition, independent data on toll revenue market share, and demand for interexchange services demonstrate that the interexchange market has expanded significantly over the last several year.

A. *GTE Sprint has asserted that the future viability of the OCCs is open to question and that competition in the long distance market is at risk*

On April 4, 1985, GTE Sprint submitted a study entitled, "Prospects for Major Facilities-Based Other Common Carriers" to the FCC as part of its Comments in Dkt. No. 83-1145 (Phase I). Conducted at GTE's request, this BAH study concludes that, under current policies, the MFBCs competing with AT&T in the provision of long distance service will earn inadequate rates of return for the remainder of the decade. Based in part on this study, GTE Sprint has asserted "that the prospects for effective competition in the long distance market are in severe jeopardy."

The BAH study states that there is a potential for a competitive marketplace, but only if a "rational" transition from monopoly to competition is effected. The study notes that without such a transition, AT&T's long distance competitors, the MFBCs will not be able to attract the necessary capital to make the investments necessary to compete effectively with AT&T's ubiquitous network. It notes too that AT&T's network was developed "at the expense of monopoly ratepayers over the past 100 years."

This study is based on five major assumptions:

Over the next five years, the MFBCs will capture all new interLATA switched voice traffic and will grow at a compound rate of 35 percent per year, while AT&T remains static. While increasing their market share, the MFBCs also will reduce their price discounts so that by 1989 they are only 5 percent below ATT-C's price.

The MFBCs will reduce their uncollectibles, now about 6 percent of revenues higher than ATT-C's current level, to within 1 percent of ATT-C's 1989 forecast level.

ATT-C will not introduce reduced pricing programs (e.g., Pro America, Opportunity Calling, and Reach Out America).

The MFBCs will improve the productivity of their assets by 100 percent and will lower their physical non-access costs by 57 percent by 1989.

GTE states that these parameters were set by Booz, Allen & Hamilton in the exercise of that firm's professional judgment and were chosen specifically to ensure that the results would fairly present the outlook for the MFBCs. If anything, GTE claims that these assumptions are somewhat optimistic and that it would be difficult to devise a more conservative approach.

Further, in a letter to FCC Chairman Mark Fowler, dated May 21, 1985, GTE's general counsel notes that AT&T's "longstanding position of market power" affords that company significant advantages that would be difficult for any competitor to overcome. They include:

Access to universal historical traffic data which gives it the ability to plan and engineer systems with greater precision.

Marketing information based on historical customer usage data that cannot be replicated by any source.

The financial strength of a company that has had decades of monopoly service with government protection in which to build its interexchange network and thus now has no need to rely on massive debt or equity offerings to meet escalating transition and conversion costs.

Highly sophisticated operating systems developed at the expense of the monopoly ratepayer which assure freedom from effective competition in the provision of 800 Service, 900 Service, and coin sent paid calling.

A completely built, high quality ubiquitous network with dialing access from every telephone in America developed over several decades from monopoly revenues. Declining operational costs as end user access charges take effect.

In a letter to BellSouth dated July 17, 1985 (see Appendix), the First Vice President of Research for Shearson Lehman Brothers, John S. Bain, states that it is difficult to assess the BAH study because GTE has declined to provide details on the precise calculations used by Booz, Allen.

In an attempt to verify those results, Shearson conducted its own analysis using publicly available MCI data. Shearson found that non-access costs (i.e., depreciation rates and the cost of capital) account for a significant portion of the cost differences between MCI and AT&T. Shearson concludes that even recognizing the tentative nature of its analysis, it appears that a more rigorous analysis of the relative financial strengths of AT&T and MCI to be in a much stronger position than casual inspection would lead one to believe.

B. Despite the OCCs' claims to the contrary, the long distance market appears to be increasingly competitive

As noted above, GTE has concluded, as a result of the Booz, Allen & Hamilton analysis, that "the prospects for effective competition in the long distance market are in severe jeopardy." Despite the fact that the staff that conducted the analysis draws no policy conclusions on the basis of its forecast, and states that their report is incapable of resolving questions about the prospects for effective competition, GTE continues to assert that the BAH conclusions inevitably lead to the fact that competition in the long distance market is at risk.

BellSouth disputes this contention, believing that evidence exists demonstrating the presence of competition in the long distance market and as equal access is implemented nationwide, such competition will increase.

The following tables demonstrates the growth in the long distance market since 1978 and the significant change in market shares in that period.

TABLE 4.—GROWTH IN DEMAND FOR INTEREXCHANGE TELECOMMUNICATIONS SERVICE

(Dollars amounts in billions)

	1978 Revenue	1984 Revenue	Increase (percent)
Intrastate	\$9.41	\$20.36	116
Interstate	13.31	29.04	121
International	.98	2.20	124
Total	23.52	51.60	119

Source: NTIA Special Publication 85-16.

TABLE 5.—MARKET SHARE AND TOLL REVENUE—1978

	Revenue (billions)	Market share (percent)
AT&T/BOCs	\$19.62	83.4
Independent Telcos	3.70	15.7
Competitive Carriers	.20	0.9
Total	23.52	100.0

Source: NTIA Special Publication 85-16.

TABLE 6.—MARKET SHARE AND REVENUE FOR TOTAL—1984

	Revenue (billions)	Market share (percent)
AT&T	\$33.25	63.5
Competitive Carriers	4.95	9.4
Local Exchange Companies ¹	13.40	25.6

TABLE 6.—MARKET SHARE AND REVENUE FOR TOTAL—1984—Continued

	Revenue (billions)	Market share (percent)
Private Microwave.....	.80	1.6
Total.....	≈ 52.40	100.0

¹ BOC's and Independent Telcos.

² Total differs from table 4 due to inclusion of private microwave.

Source: NTIA Special Publication 85-16.

These data show that the market for competitive carriers has grown rapidly. In 1978, the total estimated revenues for the non-AT&T carriers were about \$200 million; in 1984, these revenues had increased to about \$5 billion. Similarly, the competitive carriers' market share has grown from 1 percent in 1978 to more than 9 percent in 1984.

In summary, while GTE and some OCCs are not at all optimistic about the future of the competitive marketplace, the fact remains that public policy decisions in recent years have had the effect of fostering competition. There is no reason to believe, based on this one study and assertions of certain OCCs, that the marketplace will do a drastic about face. The most helpful way to ensure competition in the future is to proceed with the equal access transition plan as outlined.

V. NOTWITHSTANDING OCC CONCERNS ABOUT THE LONG TERM PROSPECTS OF COMPETITION IN THE INTEREXCHANGE MARKET, THE PUBLIC INTEREST WOULD NOT BE SERVED BY DISCOUNTING OCC ACCESS RATES IN AN EQUAL ACCESS ENVIRONMENT

In concert with the Booz, Allen & Hamilton study, GTE Sprint, U.S. Telecom, United States Transmission System and Allnet recently petitioned the FCC to conduct an expedited rulemaking proceeding on "policies necessary for a transition to effective long distance competition." Among other things the petition requests that the FCC: "reevaluate whether the premise which underlies the Commission's view of the value of Feature Group D (equal access) to the OCCs—that FGD provides marketing opportunities equal to those inherent in ATT's inter-connection arrangements—remains valid."

In petitioning the Commission to reevaluate its equal access transition plan—and to do so on the basis of the Booz, Allen study—the OCCs essentially are asking the FCC to discount Feature Group D (FGD) rates until such time as the OCCS are able to bring their non-access costs in line with AT&T's costs. For reasons outlined below, proposals of this nature will not further the government's expressed interest in promoting competition within the telecommunications marketplace.

A. OCC access rate discounts will necessarily result in a revenue shortfall

While there is no question that the availability of equal access arrangements will improve the quality of long distance services rendered by the OCCs, it is equally apparent that these improvements will involve substantial investment on the part of the BOCS. To date, BellSouth has spent approximately \$67 million in satisfying its equal access obligation and expects to incur an estimated \$78 million in additional capital investment before the transition to FGD is completed.

BellSouth's concern with the OCC petition, however, does not rest exclusively with the Company's ability to recoup investment in equal access facilities. OCC interests in FGD discounts also raise broader public policy questions about the recovery of much larger amounts of local telephone plant costs that currently are assigned to and recovered from interstate long distance carriers. Today, this interstate cost assignment represents about 26 percent of BellSouth's total annual operating expenses.

Under the Commission's current access charge plan, a local telephone company's interstate cost assignment is recovered through a combination of flat rate subscriber line charges to local residential and business customers, and both per minute and flat rate charges that are assessed to long distance carriers for their use of local telephone networks in completing long distance calls. Approximately 12 percent of BellSouth's interstate assignment currently is recovered through subscriber line charges, while the remaining 88 percent, or \$2.2 billion, comes from per minute access charges that are assessed to long distance carriers. The latter amount also is equivalent to a \$100 million monthly contribution that long distance carriers and their customers currently make toward the recovery of BellSouth's cost of providing local service.

Conceptually, then, the decision to discount FGD rates need not have an immediate bearing on the amount of local telephone plant costs that exchange companies recover from long distance carriers. In a practical sense, however, FGD discounts will result in an access revenue shortfall that will have to be made up by AT&T and/or end users.

B. The following group of scenarios show the effect of feature group D discounts on rates

Figures presented in Table 7 are illustrative of potential changes in local and/or interstate access rates that could result from FGD discounts. Two hypothetical scenarios are presented. Both are based on BellSouth's current interstate cost assignment. Both scenarios also assume that OCC FGD rates are discounted by 55 percent, the same percentage that currently applies to the OCCs' non-premium access rates.

Under Scenario A, it is assumed that the FCC would authorize local telephone companies to increase AT&T's per minute access charge by an amount that is just sufficient to compensate for losses in OCC access revenues that would ensue from FGD discounts. Among other things, these data indicate that increases in AT&T's access charges will become more pronounced to the extent that the OCCs' are successful in acquiring additional market share.

For example, if OCC market share were to remain at 20 percent and FGD rates were discounted by 55 percent, BellSouth would find it necessary to increase AT&T's exchange access rates from 7.37 to 8.28 cents per minute, or by 12 percent, in order to recover its interstate cost assignment. Similarly if the OCCs' share of total interstate access minutes were to increase to 40 percent, BellSouth's charges to AT&T would be approximately 28 percent higher with a FGD discount (e.g., 9.45 vs 7.37 cents/minute than they would be if the FCC's equal access transition plan were left intact.

TABLE 7.—POTENTIAL IMPACT OF FGD DISCOUNTS ON TELEPHONE RATES IN THE BELL SOUTH REGION

[In 1984 dollars]

	AT&T market share (percent)		
	80	70	60
Base case: No FGD discount (no revenue shortfall):			
AT&T access rate per minute.....	\$0.0737	\$0.0737	\$0.0737
OCC access rate per minute.....	.0737	.0737	.0737
Scenario A: 55 percent FGD discount (with revenue shortfall recovered entirely from AT&T's customers who reside in the BellSouth region):			
AT&T access rate per minute.....	.0828	.0882	.0945
OCC access rate per minute.....	.0372	.0398	.0424
Scenario B: 55 percent FGD discount (with revenue shortfall recovered entirely from end users):			
AT&T access rate per minute.....	.0737	.0737	.0737
OCC access rate per minute.....	.0332	.0332	.0332
Local monthly rate increase required to offset discount.....	1.37	2.05	2.73

Similarly, figures presented in Scenario B illustrate possible increases in end user charges that would result if BellSouth's end users were required to make up the entire shortfall in interstate access revenues that will ensue from FGD discounts. The figures indicate that such increases could range from \$1.37 to \$2.73 per line per month, again depending on the OCCs' market share and, thus, the amount of access revenues that BellSouth would lose to FGD discounts.

C. Given AT&T's incentives and ability to bypass local telephone networks, it is highly probable that FGD discounts will stimulate bypass

As the OCCs have pointed out in their petition for access rate relief, AT&T is becoming increasingly aggressive in reducing charges for long distance service that are rendered to major customers. It also is apparent that AT&T, in pursuit of this objective, is becoming increasingly inclined to substitute special access services that contribute little to local telephone plant costs for switched access services that do make a healthy contribution.

AT&T's recent tariff filings for Software Defined Network (SDN) and MEGACOM/MEGACOM 800 Services are two cases in point. SDN Service is a new long

distance message telecommunications service offering. It is designed to serve the needs of multilocation business customers by combining AT&T's switched network with customer-specific routing instructions that are made possible through the use of common channel interoffice signaling capacity. This will allow subscribers to create "instant" private lines between locations, paying only for the time and distance of use.

With SDN implementation, customers could utilize off-network calling capability and effectively call any location within the United States. SDN Service also could displace local exchange access lines and revenues and replace them with dedicated special access lines. Indeed, AT&T's proposed SDN rate structure will encourage such displacement by reducing rates for calls that use special access lines.

MEGACOM and MEGACOM 800 Services, in turn, are the functional equivalent of WATS and 800 Services that are now available. The primary difference is that customer access to WATS and 800 Services is provided by local exchange carrier's switched access while access to both MEGACOM and MEGACOM 800 would be provided via special access or customer-provided facilities.

Here again, BellSouth's concern is with the loss of revenues that would result from AT&T's substitution of switched access service and the practical implications that this type of bypass entails for local rates. As MEGACOM and MEGACOM 800 are targeted for customers with monthly usage in excess of 1000 hours, the loss in revenue would be significant (as high as 90 percent of a large user's switched access charge). A recently conducted usage study of BellSouth's multi-line WATS customers also reveals that the potential revenue loss to AT&T's MEGACOM Service alone could amount to as much 160 million dollars annually.

AT&T's SDN and MEGACOM Service proposals should come as no surprise to public policymakers. In December of last year the FCC published an extensive report on bypass which amply documented AT&T's interests and ability to reduce its access costs by substituting special for switched access services, thus avoiding contributions that switched access services currently make to local telephone rates. AT&T's SDN and MEGACOM proposals simply confirm the FCC's earlier prognostications about carrier or service bypass. Both proposals also demonstrate that the threat which AT&T's use of special access services poses to local telephone rates is not only very real but also increasingly immediate. BellSouth, however, does not oppose the provision of efficient and economic services to telecommunications users. We would like to be able to offer such services to customers in our region.

Given the competitive dynamics that now characterize both interexchange and exchange access service markets, it is equally apparent that FGD discounts could greatly increase AT&T's incentives to bypass local switched telephone networks. AT&T's exchange access costs, after all, currently account for approximately 60 percent of the company's total cost of providing service to end users. As a consequence, AT&T's efforts to reduce these charges will necessarily represent one of the most, if not the single most, effective method of competing for large customer accounts by offering new or reconfigured services at more favorable rates.

It also is not surprising that AT&T's SDN and MEGACOM tariff filings generally coincide with IBM's decision to heighten its presence in telecommunication service and equipment markets by taking equity positions in MCI and Rolm. Simply put, AT&T's proposals effectively serve notice on IBM and other OCCs that it will take steps to protect or increase its market share by pricing services more competitively. And that it will do so by reducing contributions that AT&T's largest customers now make to local rates notwithstanding the fact that these reductions may result in higher charges for local telephone service.

Finally, in weighing AT&T's bypass potential, it is essential that public policymakers recognize the fact that FGD availability will substantially improve the quality of access services rendered to the OCCs and, thus, their ability to compete with AT&T. Similarly, for reasons discussed above, FGD discounts will not only increase AT&T's access costs (assuming AT&T is required to make up ensuing access revenue shortfalls), but those increases will become more pronounced if, and to the extent that, AT&T loses market share to the OCCs.

Given this situation there is little doubt that AT&T will respond to FGD discounts by abandoning the use of local switched access services—whenever and wherever special access and/or stand alone facilities promise to reduce its over all access costs. That BellSouth and its customers have an apparent interest in avoiding this situation is unmistakable clear. Exchange access revenues that accrue from AT&T currently amount to approximately \$2 billion, or roughly 20 percent of BellSouth's total annual receipts. These revenues also contribute approximately \$6.50 per month toward the recovery of the cost of maintaining each of BellSouth's 14.5 mil-

lion access lines. If for any reason this contribution is lost, the result would be upward pressure on end user charges.

D. Should the FCC or Congress conclude that OCC viability is in jeopardy, there are alternative policy solutions available to policymakers that are preferable to FGD discounts

By the OCCs' own admission, their principal problem in competing with AT&T in an equal access environment does not rest with differences in the quality of FGD and AT&T premium access arrangements. Instead, as the Booz, Allen study asserts, the problem allegedly lies with differences in AT&T's and the OCCs' non-access costs. If government policymakers conclude that some type of protection will serve the public interest, relief should focus on a solution that does not involve significant modification to the FCC's current access charge policies, including its equal access transition plan.

As a case in point, there is reason to believe that any differences in AT&T's and the OCCs' non-access costs could be attributed, in large part, to differences in depreciation practices that these firms use to recover capital costs. In particular, OCC depreciation expenses are not regulated by the FCC and, thus, tend to be considerably higher than AT&T's expenses when viewed on a common basis (e.g., cost per minute of service). That being the case, the FCC could place the OCCs in a more favorable cost position vis-a-vis AT&T simply by allowing AT&T to depreciate its capital assets more rapidly.

Such an approach should serve the public interest in general and the interests of local telephone customers in particular in three important ways. First, if the FCC were to address the OCCs' alleged non-access cost disadvantage by increasing AT&T's depreciation expenses, the solution and the problem would, at least, be related.

Second, and no less important, an increase in AT&T's depreciation expenses would avoid the distinct possibility that local telephone customers would be required to make up an access revenue shortfall that inevitable would result from discounting OCC access rates.

And third, by increasing AT&T's depreciation rates, the FCC would explicitly recognize the fact that current public policies that govern the recovery of capital investment in telephone plant are in need of revision. They are in need of revision most notably because they preclude regulated carriers, including the BOCs, from depreciating plant in an economically efficient manner and at rates that are comparable to those of unregulated telecommunications vendors. Over time, disparities in depreciation policies that govern regulated and unregulated firms not only distort the ability of the marketplace to reward cost efficient competitors with larger volumes of business, they also pass today's cost of providing telephone service on to tomorrow's customers.

In raising the issue of depreciation reform, the BellSouth Companies do not wish to suggest that this is the only option that policymakers could or should consider in addressing the OCCs' alleged cost disadvantage. The Commission could deny AT&T's MEGACOM and related tariff proposals which promise to reduce rates for large volume WATS customers, but only at the expense of contributions that those same customers currently make toward the recovery of local telephone plant costs by virtue of their use of switched access services.

In weighing these and other options—and, indeed, the need for pursuing any one approach—government policymakers must exercise considerable caution in resolving issues surrounding the question of OCC viability. They should exercise caution in the interest of maintaining a delicately structured but somewhat fragile access pricing plan that will serve the entire public interest. There has been little debate about the dramatic structural changes that the telecommunications industry has undergone since the divestiture and how these changes eventually will affect local telephone service. In many respects, these changes for better or worse have subjected telephone companies, their stockholders, and their customers to considerable uncertainty. The time has come for all public officials to recognize the realities of competition in certain telecommunications markets, and the need for government to extricate itself from the business of actively intervening in the day-to-day business decisions of telecommunications firms when and wherever the marketplace can be relied on to protect consumer interests. Otherwise, uncertainties will persist and invariably distract these companies from the business of offering improved products and services at the lowest possible cost. That after all, is the primary purpose of competition.

Similarly, where competition is deemed to provide less than adequate protection of consumer interests, government policymakers should place heavy, if not exclusive, reliance on Federal and state regulatory and administrative processes in deter-

mining how telephone facilities costs ultimately should be recovered. These commissions have spent years developing, refining and balancing an extremely complex set of consumer interests that surround the recovery of exchange access costs. Given this situation, and in the absence of a much more credible and compelling showing than the OCCs have presented to date, the BellSouth Companies believe that the OCCs' current access charge policies should be left intact.

VI. A WORKABLY COMPETITIVE INTEREXCHANGE MARKET CAN BEST BE ACHIEVED BY REMOVING THE GOVERNMENT FROM THE DUAL ROLE OF HANDICAPPING CERTAIN PARTICIPANTS AND REGULATING AN INCREASINGLY COMPETITIVE TELECOMMUNICATIONS MARKET

The purpose of moving toward a competitive telecommunications system is to permit market participants to operate at peak efficiency and share the benefits of those efficiencies with their customers. In such an environment, consumers can expect cost-based prices, service diversity, and timely deployment of technological innovation. The FCC's structural separation rules and the MFJ's prohibition against certain activities by the BOCs impair BellSouth's ability to compete fully and effectively. These restrictions also handicap BellSouth in competing with foreign vendors both at home and abroad.

A. The effectiveness of competition cannot be assessed fairly until regulatory policies result in access prices that are consistent with underlying costs

The Federal Communications Commission has stated repeatedly that one of the conditions that must be present for workable competition to exist is cost-based pricing. It has acknowledged that when a competitor charges rates that closely approximate costs, customers are better able to differentiate between service providers and equipment suppliers. Similarly, when competitors are able to fit price to costs, they are better able to gauge how they are performing in a particular market.

Technological progress has been and will continue to be a major driving force in the development of a competitive telecommunications marketplace. To be successful telecommunications providers, the BellSouth Companies must be free to maximize their productivity and efficiency and share those benefits with their subscribers. In a system where prices are not based on costs, and where regulatory controls artificially control prices, the Operating Companies are not free to compete as they otherwise might be able to do, and certainly are not able to pass along the benefits of effective competition to their customers. The result of such a situation, whether intended or unintended, is regulated competition—where only certain parties are free to take advantage of market conditions.

In its recent report on domestic telecommunications policy (Special Publication 85-16), the National Telecommunications and Information Administration (NTIA) stated that there is significant uniformity between competing carriers with respect to their costs. The one area, however, where there are substantial inequities is in the area of access costs.

Initially, discounts for the other common carriers were seen as a way of introducing equilibrium into a market where conditions varied widely for different carriers. However, such discounts may bear partial responsibility for inducing excessive amounts of investment in redundant transmission capacity. Such investment may be difficult to justify as market forces change. For example, as demand for service levels off, or decreases, excess transmission capacity does not contribute to earnings. The investment remains, but the return on that investment declines. By creating an environment in which artificial conditions produce misleading market signals, participants, and ultimately consumers, are disserved. Similarly, if artificial conditions are introduced in a market as a result of rules that favor or disfavor a particular entity or group of entities, it is difficult to assess whether the rules are successful because market forces alone are not creating the conditions by which all parties abide. In addition to not knowing whether the rules are successful, it also is difficult to determine whether the resulting competition is viable, or whether it simply is an artifact of the rules.

Since the purpose of competition is to equalize participants' opportunities (and not their costs), handicapping certain players by using discounts and other such pricing mechanisms is anticompetitive. Granting concessions to certain market segments skews the ability of all participants to compete for the business of consumers on the basis of diversity, quality, innovation, specificity, or other such factors. The purpose of competition, and certainly the purpose of the divestiture of the Operating Companies from AT&T, was to bring the benefits of competition to residential and small and large business consumers alike. These benefits were to be in the form of service diversity, lower or more stable prices, and the deployment of technological innova-

tion. These results cannot be expected to occur until all carriers have an equal opportunity to compete and until government minimizes its involvement in shaping market forces.

B. Competition will not be fair until regulatory policies create equal opportunities for all participants

BellSouth supports the FCC's procompetitive policies because it believes that competition not only will benefit its two Operating Companies and their subscribers, but also will have wide-ranging benefits for the Nation's economy and the U.S. position in international telecommunications markets.

The BellSouth Companies are eager to participate fully in the telecommunications marketplace, both at home and abroad. Although our principal responsibility is, and will continue to be, providing reliable and affordable local exchange service to all consumers in our nine state region, the family of BellSouth Companies has diverse capabilities that could, if put to full use, enhance both domestic and international telecommunications markets.

However, both the Federal Communications Commission's Computer II rules and the Modification of Final Judgment impose certain conditions, restrictions, and prohibitions on the former Bell Operating Companies.

SECOND COMPUTER INQUIRY

In the First Computer Inquiry (Computer I), the FCC had declared that "communications" offerings would continue to be treated under the 1934 Communications Act and that "data processing" offerings would continue to be unregulated. It also said that (non-Bell) regulated carriers could provide data processing services, but they would be required to do so on a structurally separated basis. At the same time, the FCC acknowledged that computer technology could and should be employed to automate and support conventional communications service. The Commission also identified a third category, a "hybrid" one, where computer technology could support both data processing and communications. Computer I did not address the provision of data processing by AT&T or the Bell Operating Companies because it was thought that these Companies were prohibited from providing such service under constraints imposed by the 1956 Consent Decree.

In the Second Computer Inquiry (Computer II), the FCC maintained the unregulated treatment of data processing, but refined its definition using a new term, "enhanced services," and eliminated the uncertain "hybrid" category. As a result of approximately fifteen years experience under Computer I, the FCC reexamined the structural separation approaches of the first investigation, refined them, and applied them in one form to AT&T and the Bell Operating Companies, and in another form to all other carriers. At the same time, the Commission required that all customer premises equipment (CPE) be provided on an unregulated basis.

In its recent Notice of Proposed Rulemaking in CC Dkt. 85-229, the FCC states that "[a] fundamental purpose in instituting Computer II was to avoid the ambiguities and uncertainties that were becoming increasingly apparent in the application of the 'data processing' and 'hybrid' definition of Computer I to services. Likewise, customer premises equipment was impossible to classify as traditional mere voice equipment or data processing equipment."

The Computer II rules also impose structural separation requirements on AT&T and the Operating Companies. Absent a waiver of the structural separation constraints, facilities that create or implement "enhanced services" are not permitted to be integrated with facilities used to provide common carrier communications. The FCC has noted, however, that in some cases, these capabilities cannot be efficiently created unless they are integrated with the underlying common carrier service. And in so noting, the Commission has acknowledged that as a result, the public has been denied the benefits of efficient services that might otherwise be offered through such integration.

One area where this is the case is protocol conversion, which is an element of the "enhanced services" definition in Computer II. The Commission has stated that if protocol conversion is not integrated with communications facilities, it certainly can be performed effectively elsewhere, but at a higher cost to customers. In addition, the Commission's 1983 decision established a framework within which Computer II's inefficiencies could be addressed through ad hoc waivers. The FCC acknowledges, however, that this fails to take into account the uncertainty this type of approach generates and the effects it has on such a capital intensive industry where planning for new services and facilities often takes years.

A second area where similar issues have arisen is voice storage. After Computer II was adopted, the FCC was asked to address the issue of whether Custom Calling

II voice storage services should be subject to structural separation requirements. AT&T told the FCC that such services would be uneconomical if offered outside the network on a separated basis. AT&T's opponents told the FCC that competitors could offer comparably desirable services if offered in competition with AT&T's separate affiliate. AT&T's opponents also argued that the resulting competition would promote efficiencies to offset the efficiencies lost by preventing the co-location in AT&T's and the BOCs' central offices of the voice storage equipment needed to implement Custom Calling II. In its Notice in CC Dkt. 85-229, however, the FCC notes that it accepted the arguments of AT&T's and the BOCs' opponents regarding the competitive effects of permitting co-location and the result over the past five years has been that identical services have not emerged as opponents said they would, and the public has been denied access to a service that a carrier, or carriers, were willing and eager to provide.

A third area where similar issues have arisen is new routing and call set-up capabilities proposed to be introduced in basic switched services. Virtually any new call routing feature that AT&T or the Operating Companies might propose to introduce can be, and probably would be, challenged as violating the Computer II rules. The FCC notes that most of these do not involve manipulation of information or even protocol conversion. They do, however, involve the use of stored data in and by the network to set up calls or deliver information concerning calls. While the Commission acknowledges that services of this nature ultimately could be used as alternatives to true information manipulation or retrieval services, the ones proposed have not risen to that level. In this instance, the FCC has been asked to bar the introduction of new network capabilities not because of the current proposed uses to which they would be put, but because of the uses to which they might be put some time in the future. The Commission properly notes that to the extent it might accept arguments of this nature, the public would suffer.

These constitute just a few examples of effects of the Second Computer Inquiry rules. These are just isolated examples of specific services that may not be offered, or may be offered only in conjunction with certain conditions. The more important point is that these prohibitions are inconsistent with the government's policy of fostering competition in telecommunications markets. By prohibiting the integration of specific services and facilities, the FCC has prohibited the offering of such services by the Operating Companies by making them uneconomic. It has said to the Companies that the only way the OCCs will compete with the BOCs is by handicapping the OCCs. And as the FCC has pointed out, it has handicapped them to the extent that both Operating Companies and customers suffer.

When seeking to serve the telecommunications needs of large users, the Operating Companies are operating under an obvious and visible disadvantage. The problems caused by the inability to joint market network services and customer premises equipment are significant. This occurs because, for almost every network service offered, some type of end user customer premises equipment is required to use that network service. The problems not only add to costs, but additional penalties to our customers can be substantial. Examples of such penalties include:

- The extra time required when dealing with two separate sales forces and coordinating multiple proposals.

- The uncertainty of obtaining the most effective telecommunications at the lowest cost due to the inability of two separate sales forces to present the most advantageous combination of products and services.

- The increased need for subsequent order changes by customers who must do their own installation coordination between equipment vendors and the BOCs' network services, and who may not have, or be able to afford, the necessary expertise.

- The less timely provision of services due to the lack of coordination.

- The uncoordinated installation of customer services and equipment because employees of one separate subsidiary may not talk to employees of another subsidiary unless the customer has designated by letter the equipment vendor to act as agent in procuring network services.

- The inaccuracies in subsequent billings for services, especially in the case of frequent changes.

- The penalty in time, effort, cost, and frustration associated with a customer's ongoing internal communications management.

It is clear that the trend is for large users to insist on a single point of contact with a single vendor to provide procurement, installation, operation and maintenance of telecommunications services. A good example of this is a view of the future communications requirements of the Federal government. The General Services Administration (GSA) has opened the bidding process for replacing the Federal Telecommunications System. The GSA has stated that the government wants one con-

tractor to provide service for 1.3 million government workers for a period of ten years starting in 1989. This represents about \$4.2 billion in telephone service. Because of the FCC's Computer II rules, BellSouth may not participate in the bidding process.

The inconvenience may be even greater for residence and small business customers who lack the knowledge and resources needed for selection of telecommunications services and equipment. The best way to fulfill this need is to allow the Regional Holding Companies to jointly market services and equipment to those customers.

The restrictions on BellSouth are in sharp contrast to freedom afforded other competitors, such as the IBM/MCI/Rolm combination and the prospective ATT-C/ATT-IS combination, both of which are able to offer integrated packages of services and equipment.

The inability of BellSouth, one of the largest and most experienced U.S. telecommunications companies, to provide the full benefits of technologically advanced services and equipment to its customers, both large and small, urban and rural, exacts a penalty far more severe than the risks of allowing competition to develop on an equal basis.

When the public policy justification for imposing these restrictions on BellSouth and the other regions is examined, it is difficult to understand how they can be applied to one set of competitors and not another—particularly when the resources of the regions' competitors are considered. BellSouth believes that such a scheme is increasingly difficult to justify particularly when the inconsistencies between encouraging competition on the one hand—and denying users a choice on the other hand—are so obvious. Allowing IBM and Rolm to make joint marketing visits, and allowing ATT-C and ATT-IS also to make joint marketing visits is difficult to understand in light of the prohibition against BellSouth and its subsidiary, Advanced Systems Incorporated, to act in a similar manner. Again, BellSouth does not oppose such opportunities for IBM or AT&T; BellSouth would like to have similar opportunities.

It is generally agreed that the essential premise of the Second Computer Inquiry rules is to prevent cross subsidies between competitive and regulated service offerings. With the advent of new digital technologies and the ability of interexchange carriers and customers to bypass the local network, BellSouth believes that an environment has evolved which precludes such cross subsidies. An NTIA noted in its recent report on domestic telecommunications policy, it is unlikely that an Operating Company will be able to subsidize a competitive offering with the proceeds from a regulated one since it is generally agreed that with respect to the provision of local exchange service, rates charged customers fall far short of the cost of providing that service. It is more likely that an Operating Company would take the proceeds from a competitive offering and apply them to recovering the costs of the regulated one.

It would appear that, as NTIA has recently stated, the FCC may have "overestimated the need for its policy of 'maximum separation,'" particularly, as NTIA notes, given the subsequent AT&T divestiture. At the same time, it is equally possible, as NTIA suggests, that the FCC underestimated the costs such an approach would entail, "especially those costs imposed on the general public by virtue of service options foregone, inconvenience, and what today is referred to colloquially as the 'hassle factor.'" Finally, NTIA has stated that not only have the societal and economic costs of the Second Computer Inquiry rules . . . grown, . . . these costs are likely to increase commensurate with increases in the capabilities of the telephone network and public demand for new services."

Since there is not perfect uniformity of agreement on the subject of cross subsidy, it may be appropriate for the FCC to consider alternative ways of dealing with the issue of commingling proceeds from regulated and competitive offerings. Several options include: detailed accounting records, unbundling service offerings, transfer pricing, separations reform, altering capital recovery methodology, and pricing flexibility. Whatever the option, it should be simple and should not handicap the BOCs in their competitive battles against AT&T, IBM, and other strategic competitors that may emerge.

MODIFICATION OF FINAL JUDGMENT

In addition to restrictions imposed by the Federal Communications Commission, BellSouth operates under restrictions embodied in the Modified Final Judgment resulting from the 1982 settlement of the government's antitrust suits against AT&T.

The MFJ was an attempt to resolve disputes between the Justice Department and AT&T that had been outstanding for over 30 years. During that period, the government's legal claims and policy objectives shifted substantially. When the original Western Electric decree was entered in 1956, the government's focus was largely on telecommunications equipment procurement. In the more recent suit against AT&T, which resulted in entry of the MFJ, the government's primary focus was on the intercity communications market.

The MFJ seeks primarily to separate competitive activities from those perceived to be non-competitive. The approach is direct and uncompromising. The spun-off Operating Companies cannot:

- Provide interexchange telecommunications services or information services;
- Manufacture or provide telecommunications products; or
- Provide any product or service, except exchange and exchange access service, that is not a natural monopoly service actually regulated by tariff (except customer premises equipment and directory advertising).

There are provisions for the divested companies to enter other businesses by petitioning the court and showing that there is no substantial possibility that they could use their monopoly power to impede competition in that market. This is what is referred to as the "waiver process."

Using this "waiver process," the regions have sought to enter various new markets and, more importantly, respond in their traditional exchange service markets to developments in customer demand and technology. The court ruled in July 1984 that (a) any entry by the regions into new markets has to be performed through separate subsidiaries and (b) no modification of the interexchange, information service, or manufacturing restrictions will be considered for the present. Earnings from activities entered under waiver also are subject to a limitation not to exceed 10 percent of the parent's revenues, and the new companies may not rely on any revenues or assets of the regulated telephone companies.

The MFJ's restrictions limit the region's business opportunities, their ability to respond to competition and new technology in their exchange markets, and their prospects for growth and ability to attract capital. The procedures necessary to obtain waivers require two separate public comment periods, thereby ensuring passage of substantial time, typically several months.

While AT&T is under one restriction, the regions are broadly prohibited from engaging in any activity not specifically permitted by the court. Thus, any of the numerous foreign and domestic participants in the American telecommunications industry are free to enter any part of the industry, offering their products in combinations most suitable to customer needs at any particular time or place. Only the regions lack this freedom.

Deregulation of telecommunications services and equipment markets, rapid proliferation of new technologies, and vanishing distinctions between computers, switches, data processing, communications, and even financial services, have produced a great deal of complexity. A few examples illustrate how the MFJ's restrictions disadvantage the regions in dealing with these changes. First, carriers offering mobile radio service or cellular mobile telephone service also can provide their customers the added convenience of an answering service or voice storage retrieval (i.e., information services). As a result, the regions cannot compete for a significant class of important customers. Second, the "smart building" industry includes firms that are free to offer a range of products and services such as computers, voice and data services, all in a single package. The MFJ, as currently interpreted, greatly limits the regions' participation in this market because they are not permitted to offer the complete range of activities needed to compete effectively. Third, the regions are not only restricted to providing local communications services, but under a position recently taken by the Department of Justice, they cannot even offer those services outside the franchised area they served at divestiture. Paradoxically, this would produce the equivalent of a horizontal market allocation among the divested companies. Resolution of this last illustration currently is pending before the court.

C. Public policy restrictions on the regional companies exacerbate the U.S. trade deficit

Waivers have been granted to the BellSouth Companies that relieve them of some restrictions in doing foreign business. There are still restrictions on those activities, however, that are inconsistent with the "bottleneck" theory of regulation and the current trade environment. In the past few years, the U.S.'s declining position in international telecommunications trade has contributed significantly to the soaring U.S. trade deficit. An example of this is the trade balance in telecommunications equipment, as reported by NTIA, which last experienced a positive flow in 1982 and

worsened to a \$1.04 billion deficit in 1984. Foreign competition for domestic markets was given a boost by the FCC's 1976 equipment registration program, and competition accelerated when the 1984 AT&T divestiture opened new markets. Compounding these events was the rapid advance of technology, its incorporation in foreign-produced products, and foreign companies greatly increasing their competence in international markets.

A healthy growth in worldwide telecommunications equipment and services with a growth rate of 8 percent and 9 percent respectively is expected by NTIA. NTIA projects the worldwide market for telecommunications equipment and services will grow from \$325 billion in 1984 to \$539 billion in 1990 with the U.S. market being slightly less than one half of the worldwide market. The favorable growth rate and the sheer size of the market combined with the trend in globalization of domestic and foreign companies create an international marketing challenge for U.S. telecommunications companies which must be addressed if they are to contribute to the trade deficit reduction. What appears to be a good opportunity for our telecommunications industry is seriously diminished, however, by restrictions and conditions placed on seven of our largest and potentially most effective participants by Computer II, MFJ decisions, and the MFJ waiver process.

The regional companies represent over half of all U.S. telecommunications resources but are precluded from maximizing their ability to contribute to the reduction of the U.S. trade deficit. BellSouth agrees with NTIA's recent criticism about the regions' international situation in its report on domestic policy which states "[a]t the same time we impose such needless restrictions on U.S. firms, we have opened our markets to all manufacturers and service providers. In fact, it is possible under our laws for a foreign concern to completely own and operate any telecommunications facility as long as the radio spectrum is not licensed to the foreign entity. The contrast on how we treat foreign firms, yet restrict our own, is striking."

BellSouth believes that the regions can further aid in reducing the U.S. trade deficit if they are allowed to compete domestically on an equal basis with other industry participants, both domestic and foreign. This can be accomplished by promoting the international competitiveness of U.S. companies through providing cost effective and up-to-date domestic communications products and services. The promotion of competitiveness is based on a widely accepted premise that a company can be more competitive by improving its information flow with a focus on increased business effectiveness and efficiency. The FCC, the Department of Justice, and the courts embrace the idea that competition breeds innovation and better price performance in the telecommunications industry, all of which is to the end user's benefit. If allowed to compete fairly on all competitive fronts, a regional company can help support this idea and bring increased benefits to end users. This can be achieved by utilizing its resources in whatever integrated fashion best addresses marketplace needs.

BellSouth's recommendation to government policymakers in simple and straightforward. Permit regions to compete freely in foreign markets and also permit them to compete in domestic markets against foreign suppliers. Allow regions to apply their resources to reduce the soaring trade deficit. Remove or reduce restrictions so the regional companies can provide the most effective telecommunications equipment and services thereby positioning all American companies to compete more effectively in the international marketplace.

D. Consumers ultimately bear the costs of unequal regulatory treatment of participants in the telecommunications market

The preceding sections contain examples of regulations or restrictions that have been selectively applied to the BOCs resulting in a diminution rather than an expansion of service.

These examples show that in the case of structural requirements, unnecessary costs are generated in conjunction with duplication of functions and resources in both the regulated side of the telephone business and its competitive subsidiaries. In addition to losses in economies of scope and integration, such requirements impose costs on consumers as well. Such costs are not always given full consideration by those who develop or implement a particular regulatory policy. Whether consumer loss is in terms of inconvenience or diversity of service providers, such effects must not be ignored.

In cases where services are prohibited entirely, the loss is twofold. First, diverse and capable companies are denied the opportunity to take the fullest advantage of their abilities in terms of creativity, technological know-how and financial resources. Such inefficient use of resources is antithetical to the purpose of a regulated utility. Second, as noted above, consumers find their choice of service providers

limited not by the inability of a company to meet their needs, but by a government regulation.

In the case of telecommunications competition abroad, the Bell Operating Companies are ideally situated to market their talent and technology to those who have not had access to such a high degree of expertise. Since there is no possibility of such companies exerting undue influence in any way in foreign markets, it is difficult to comprehend the justification for such a prohibition. In addition, BellSouth welcomes the opportunity to compete in domestic markets against foreign suppliers.

There are instances in domestic markets as well where the Operating Companies are permitted to participate, but conditions imposed are so unequal as to suggest that they have been designed with the primary purpose of discouraging competition, not fostering it.

The Cox Cable decision, adopted by the FCC on August 7, 1985, is an example of such regulation. The 1984 Cable Communications Policy Act deregulated all cable services. At the same time, it also left unresolved the question of whether institutional or non-cable services provided by cable systems should be regulated or deregulated.

In the Cox decision, the Commission preempted state and local regulation of facilities located wholly within one state and used to originate, distribute or terminate interstate communications including facilities that also distribute intrastate communications. Specifically, it preempted the prior state certification requirements imposed by the Nebraska Public Service Commission in connection with the provision of institutional services offered by Cox's subsidiary, Comcline of Omaha, Inc.

The remaining question to be resolved, now that entry into such areas has been established, is whether local telephone companies and cable systems will be afforded the same regulatory treatment by state and Federal officials when they both engage in the provision of comparable intrastate data and voice service. Currently, the prospects for equal treatment are not good. Although telephone companies now provide these services under tariff, it appears that neither the FCC nor state commissions are inclined to require cable operators to file tariffs in conjunction with these services. The Cable Act gives the FCC permissive authority to require cable operators to file "informational" tariffs when they offer common carrier-like services, but in its recent proceeding to implement the Act, the Commission declined to exercise that authority. So in the future, when telephone companies and cable systems offer competing voice and data services in a discrete market, the telephone company will do so on a regulated basis, under tariff, and the cable company will be unregulated.

The data transmission business is a good example of a market segment that is expanding rapidly. It is to be expected that local telephone companies would be just as interested in capturing a share of this lucrative market as would any other telecommunications service provider. In addition, it would seem just as obvious that businesses interested in having data transported would want to choose the best vendor from among all possible competitors. If unequal regulatory treatment of cable and telephone companies becomes the rule, and not the exception, it is unlikely that telephone companies will become major players in this market. Although preparing and filing tariffs do impose costs on a company, the more significant adverse effect results from the public availability of a competitor's price structure, cost support, data and policy provisions for a particular service. An unregulated entity can respond competitively to such information in a shorter period of time than a regulated entity that must provide the service in compliance with a set of rules. Such unequal treatment can have no other effect than to discourage competition.

The broad effect of this approach is to discourage efficient use of resources and to impose unnecessary costs on a particular subset of competitors. As noted above, the purpose of government policies that attempt to create a competitive telecommunications system is to permit market participants to operate at peak efficiency. In such an environment, consumers can expect price stability, service diversity, and timely deployment of technological innovation. When unequal regulatory treatment exists in a market, consumers can expect fewer choices in terms of price and service, and also fewer technological innovations.

The BellSouth Companies are fully committed to providing reliable and affordable local exchange service to all residential and business consumers in their region. But BellSouth also is concerned that its ability to meet this commitment not be affected adversely by government policies originally intended to foster competition, that result in the opposite effect. Universal service and rate stability are critical to BellSouth's mission, and unequal regulatory treatment that subsidizes some entities and handicaps others disservices all consumers.

VII. CONCLUSION

Barring a complete reversal of recent public policy decisions, the telecommunications marketplace will continue to become increasingly competitive. The ultimate beneficiaries of any competitive market can and should be consumers. They benefit through more choice with respect to the price/quality tradeoff.

The subject of competition in the long distance market and related issues that are being considered by the Subcommittee on Communications in this hearing perfectly illustrate the dilemma faced by those responsible for successfully guiding the industry through its restructuring.

Everyone agrees that competition is a desirable goal. There is, however, considerable disagreement on how that goal can best be achieved. As proposals are advanced, such as those now being considered, we have to be certain that the cure is not worse than the ailment.

The issues are complex and clear cut solutions are elusive. But the way in which resolutions are reached will have a profound effect on the strength and vitality of our Nation's communications infrastructure for years to come.

BellSouth wants to play a vital role in the future. It can best do that by being allowed to compete on an equal basis with other full service providers in the telecommunications marketplace. We are hopeful that the FCC, in its *Third Computer Inquiry*, will entertain requests for relief from the restrictions against joint marketing of basic services, enhanced services, and customer premises equipment. Removal of those restrictions will allow BellSouth to meet customers' demand for "one stop shopping."

On the subject of equal access, BellSouth believes that the public interest will best be served by allowing the equal access transition to occur as currently outlined. Reliance should be placed on existing national forums, corporate interfaces and Federal and state commission procedures in guiding the transition process to a successful conclusion.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR GOLDWATER AND THE ANSWERS

Question. Divestiture is only 20 months old. The transition to equal access, as you have testified, is an enormously complex and unprecedented task. Isn't it possible that when a telephone company office is upgraded to provide "equal access" that there are, at first, technical problems with the new connections?

Answer. Before an office is "cutover" to equal access, acceptance tests are performed to verify that the interconnections are technically correct and operate properly. These tests are made by BellSouth's operating companies jointly with each individual interexchange carrier that has requested service in that office. Any technical problems discovered during these acceptance tests are corrected prior to the cutover date.

This conversion to equal access is a task that requires both the BellSouth operating companies and the interexchange carriers to work cooperatively. To date the BellSouth operating companies have converted 37 tandem and 356 end offices representing approximately 8 million access lines to equal access. BellSouth is not aware of technical problems with any of these connections which would inhibit the provision of equal access.

Question. Once you have converted an office to equal access, do you provide the same quality connections to all long distance companies—AT&T and its competitors?

Answer. Once an end office has been converted to equal access, all long distance companies, including AT&T, are provided exactly the same quality connections. These connections include the ability for the participating long distance companies' end user subscribers to dial using the standard 1 + area code + local telephone number dialing format.

It should be noted that while comparable quality access is available in each equal access office, the interexchange carriers make their own decisions on the type of access they employ. There are cases where a carrier elects to retain the existing Feature Group A access, even though Feature Group D service is available. Thus all BellSouth can do is make the same quality connections available and let each carrier determine how it wants to serve its own customers.

Question. MCI has recently stated to the Department of Justice that there are a number of problems with the customer subscription process. What are you doing to

ensure that customers who sign up with a particular carrier are in fact connected to the selected carrier?

Answer. BellSouth provided to the DOJ a detailed point-by-point response to MCI's complaints. BellSouth's operating companies are working diligently and even-handedly with all interexchange carriers, both individually at the local level and via the National Interexchange Carrier forums, to resolve any and all problems that arise. Many of the problems cited by MCI had been resolved through this process prior to the date of MCI's petition to the DOJ. In many cases, including some of those listed by MCI, the problems arise due to the actions of the interexchange carriers themselves. Solutions to the problems, whatever the source, can only be implemented if a cooperative attitude is put forth by all of the parties involved.

BellSouth performs numerous internal tests to verify that all subscribers are connected to the interexchange carrier (IEC) of the subscriber's choice. BellSouth has provided the ability for the subscribers of all interexchange carriers to verify that their calls are going to the IEC of their choice. This is done, independently of BellSouth, by having the subscriber dial 700-555-4141 which connects to a recording provided by the IEC.

Question. Do you consider the availability of upgraded "Feature Group D" facilities to be "equal access?"

Answer. Feature Group D service is designed to provide and does provide all interexchange carriers with non-discriminatory access that is equal in type and quality to that provided to AT&T.

Prior to the approval of the Modification of Final Judgement all interexchange carriers were given the opportunity to comment under the terms of the Tunney Act. After extensive comments by a number of parties, including the interexchange carriers, the standards for equal access were worked out, included in the MFJ, and accepted by the Court. Feature Group D service is in full compliance with the agreed upon requirements of the decree.

Senator GOLDWATER. Thank you, Mr. Ackerman and Mr. Chairman.

Do you have any questions?

The CHAIRMAN. I do not.

Senator GOLDWATER. I have one question that I would like to ask Mr. Prendiville, because it is a technical subject that has interested me for some time.

In your written testimony you are talking about equal access, and you say we all know the process of making long distance phone calls used to be quite simple. The customer would normally dial 1 plus the area code plus the 7-digit telephone number being called, and until a few years ago the call would have been carried over the long-distance network of the Bell System.

Then, of course, I have heard, as you say, that it could take up to 24 digits to place a long-distance call, and as you say in your testimony as a result of equal access many of your customers can use the 1 plus area code and number.

Does that apply across the board? And another part of that, does equal access make that possible?

Mr. PRENDIVILLE. When we provide equal access in an office that has that capability what it implies is that a customer can select any one of the interexchange carriers who elects to serve that office: MCI, GTE, AT&T, etc. And the call that he normally dials, 1 plus, will go to his selected interexchange carrier.

He still has the option of dialing the other carriers, but he has to dial 10XXX. Equal access in terms of dialing means that he now can select among carriers, and the one he preselects will transmit the 1 plus call.

Senator GOLDWATER. Do all of your systems have WATS systems available?

Mr. PRENDIVILLE. Do we have WATS systems?

Senator GOLDWATER. WATS.

Mr. PRENDIVILLE. We can provide both 800 service, that is incoming WATS, and outgoing WATS from all of our existing systems today. But to provide it we use the AT&T systems, or the customers use the AT&T systems, for inter-LATA services. We have before the DOJ, as do all of the regions, a request for us to provide 800 service on an equal access basis.

Senator GOLDWATER. Thank you. I have just a few questions, and any one of you can answer these.

After you get an equal access order, in other words a customer wants to change from one carrier from another, how long does it take for you to actually make the change? If it takes more than a couple of weeks, do you not think that frustrates the customer?

Mr. ACKERMAN. Mr. Chairman, when a customer places an order to change from one carrier to another, it generally does not take longer than it does to process any other order in the way we do our normal business.

I think it is important to point out here that with the volume of business we do, and we are talking about cutting 20,000 lines a day, from time to time you may encounter a situation that would take a little bit longer. But in the normal course of doing business it should not take any longer than the normal intervals in which we handle our business.

Mr. PRENDIVILLE. In the case of NYNEX that would normally be the customers in an office that already has equal access and wants to change from carrier "A" to carrier "B", and that would normally take 3 to 5 days.

Mr. CALLAWAY. That is the case in our company, too. I think as you go through the equal access process and convert an office, it is a little different process, but once an office has been converted it just takes a matter of a few days to make that change.

Ms. STONEY. I would agree. Our procedures are the same.

Senator GOLDWATER. For you, Ms. Stoney, or Mr. Callaway, if the definition of equal access was changed by the FCC to mean equal value or equal market, will this extend the period of the access discount and, if so, who will pay for the change in the definition? Bell companies or consumers, or just who?

Ms. STONEY. Well, first of all the access charges today are cost based, and they were ordered to be that way, and that is the way we have designed the rates. A value base would imply a market based price, and I would suggest that the FCC may not be best—or any regulatory body—in a position to determine what the market-based price would be.

We would favor a market-based price which would imply deregulation of all access services, and we would be free to price access services based upon the market. I think that is the way we will find out what the real value of the services are.

I am not sure I recall the second portion of your question, Senator. Would you repeat that again, please? If that were ordered, who would pay?

Senator GOLDWATER. Yes. Who would pay for the change in the definition of equal access? Bell, the consumers?

Ms. STONEY. If the definition were to imply that some continued subsidy of other common carriers would continue beyond the date

of equal access, and if it were assumed that that burden would be borne by the operating telephone companies, the Northwestern Bells of the country if you will, then we would see a need to regain those revenues from our end user customers in some other form.

Senator GOLDWATER. I do not have any idea that the FCC is going to try to make these changes, but sometimes we get surprised.

Now, MCI has recently stated to the Department of Justice that there are a number of problems with the customer subscription process. What are you doing to insure that the subscription process works to insure that customers who sign up with a particular carrier are in fact connected to the selected carrier?

Mr. ACKERMAN. Mr. Chairman, we at BellSouth feel we have done a good job working on equal access. We feel that as we continue to work with the carriers in the forums that we have talked about, there are plenty of opportunities for us to resolve any problems that do come about.

We feel that, in working with these particular interexchange carriers, we have an opportunity to help them to succeed because we absolutely want them to succeed. The better they do the better we are, because the more competition there is in the interexchange carrier market, the more traffic that will flow over our local telephone networks and the better off we are going to be.

Mr. PRENDIVILLE. In NYNEX working with MCI, we have had a series of meetings with their executives in the northeast region. We have discussed any problems that have come up. We have had a series of discussions to be sure that the quality of our processing of their orders is effective. When we found difficulties we corrected the problems.

In addition, we have pointed out to MCI that some changes in their procedures, for example, would make the processing of those orders go much more smoothly and much quicker, and we are ready to continue and will continue those discussions so that we assure the quality of their product. It is of no advantage to us not to have a presubscribed order correctly processed.

Mr. CALLAWAY. The problem you mentioned received quite a bit of national attention, also, not too long ago, and in Southwestern Bell we took a look at that problem and found that we had some 2,000 lines that appeared to potentially have been routed to AT&T because of its error instead of to MCI. When investigating each of those lines we in fact found only 70 that were a problem, and we resolved each of those satisfactorily.

I would just like to point out that when you have 70 cases and you cut some, at least half of our lines, around 5 million lines to equal access, that does not appear to be too much of a problem. With the presubscription process, we feel pretty good about that particular situation.

Ms. STONEY. Could I make just a short comment? I think it is important for us to look back and understand that when we approached divestiture we were talking about a corporation with somewhere, give or take a few billion, 140 billion dollars' worth of assets; \$50 billion or so in revenues; and 20-plus operating companies with many, many hundreds and thousands of different systems.

Even though we portrayed ourselves as one system, in fact, not all of the systems were designed identically in all of the operating companies. This is a massive undertaking. There are millions of lines being cut.

We feel very proud of the fact that not only have we, from the beginning, dealt with the carriers as our major customers—they are our largest customers—but, moreover, we developed and pioneered the balloting process; the advertising that I described in my testimony; the clustering concept which we think has enhanced and will continue to enhance the marketing efforts.

We have every intention of doing everything we can on an even-handed basis to enhance the marketing efforts of those carriers. It is in our best interest.

Senator GOLDWATER. Thank you, and I want to thank all of you for being here today.

The CHAIRMAN. Could I just ask one final question?

Senator GOLDWATER. Yes, sir.

The CHAIRMAN. Mr. Calloway, with the changing times in telephone service deregulation and the whole new system, are you confident that the people of our State will—the residents, the residential phone users in our State—will continue to be able to have access to residential phone service at rates they can afford?

Mr. CALLAWAY. I think so. We certainly have had some confusion, and we are working our way through that confusion. We and the other telephone companies certainly have our eye on the target, and that target is providing quality customer service to all of our customers.

We have an eye on the target of equal access, and we are moving very rapidly to provide equal access which is going to create that competitive long distance market.

So, I think the people of Missouri are in good hands in terms of us working through the problems at hand.

The CHAIRMAN. Thank you, Mr. Chairman.

Senator GOLDWATER. I just want to thank you people. You were the last group to testify, and I have to say you are about the only ray of sunshine we have had all day.

This is not an easy problem, but listening to you four people reminded me that Americans can whip most anything, so just keep it up and maybe we can get this whole thing fixed up.

The meeting is adjourned.

[Whereupon, at 4:45 p.m. the committee recessed subject to the call of the Chair.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

STATEMENT OF THE BELL ATLANTIC OPERATING TELEPHONE COMPANIES

This testimony is filed on behalf of the Bell Atlantic Operating Telephone Companies—the Bell Telephone Company of Pennsylvania, the Diamond State Telephone Company, the New Jersey Bell Telephone Company, the Chesapeake and Potomac Telephone Company (Wash., D.C.), the Chesapeake and Potomac Telephone Company of Maryland, the Chesapeake and Potomac Telephone Company of Virginia, and the Chesapeake and Potomac Telephone Company of West Virginia.

Bell Atlantic welcomes the opportunity of describing the commitment of our resources and employees to the role we have played in introducing competition into the long-distance market. The purpose of this testimony is to describe the actions taken by the Bell Atlantic telephone companies to guarantee the success of converting the nation's telecommunications network to one which offers equal access to the interexchange carriers and to the public. Bell Atlantic also takes this opportunity to set forth its views on what additional steps need to be taken to permit the full benefits of telephone competition to be realized by the end user customer.

One of the principal conditions of divestiture is that the Bell Atlantic telephone companies (and the other divested Bell telephone companies) must provide all long-distance companies access to the exchange network equal to that provided to AT&T. Equal access allows customers to place long-distance calls with the interexchange carrier of their choice simply by dialing the telephone number (prefixed by "1" where required). This new easy dialing procedure allows customers to choose the long-distance company that best suits their requirements and eliminates the need to dial as many as sixteen extra digits. Customers may also use other long-distance companies, in addition to their primary carrier, by dialing a five-digit prefix.

The equal access service delivered by the Bell Atlantic telephone companies to the interexchange carriers is the same as that delivered to AT&T. Nothing in the equal access service we provide diminishes its value or limits the ability of the interexchange carriers to market their services in competition with AT&T.

Bell Atlantic realized that to meet the spirit, as well as the letter, of the equal access requirement, resources should be dedicated to opening lines of communication to the interexchange carriers, particularly since they had varying ideas and approaches to implementing what was a new process for everyone. In December, 1982, long before the first telephone switching office was converted to equal access in July, 1984, and in anticipation of the interexchange carriers' need to know Bell Atlantic's policies regarding the provisioning of access services, our Business Relating group was established. Its purposes is to maintain two-way communications with the interexchange carriers. Accordingly, the Business Relations group is charged not only with enunciating policy decisions, but also with leading the interdepartmental/intercompany effort at providing fair and equitable solutions to the problems of our customers in their business dealings with Bell Atlantic. We feel strongly that continued direct communications is the surest way of guaranteeing the success of the equal access conversion process.

To acquaint the interexchange carriers with Bell Atlantic's policies, Business Relations has, since January 1, 1984, conducted three seminars. Also, to address our customers' need of a detailed understanding of Bell Atlantic's access provisioning and maintenance procedures, we have conducted three "hands-on" workshops in the same period. These workshops have been supplemented by the publishing and regular updating of detailed descriptions of our interface guidelines and equal access methods and procedures.

In terms of our dealings with individuals interexchange carriers, since January 1, 1984, we have answered about 3,000 letters and questions raised by them, as well as sponsored or participated in numerous one-on-one meetings. In addition, we initiated hundreds of letters and calls to the interexchange carriers on matters of importance to them. Lastly, at the national level, members of the Business Relations group have served as participants in panel discussions sponsored by groups such as

COMPTEL, a national association of resellers, and Telestrategies, an organization that sponsors industry-wide seminars.

As a further effort to minimize any difficulties the interexchange carriers may have in their dealings with us, we have established two other groups that also work full-time to meet these customers' business needs. One of these groups, known as Intermediary Marketing, is charged with being the primary contact in Bell Atlantic for the interexchange carriers who wish to order equal access or other access services. In addition, account representatives from Intermediary Marketing serve their individual customers as the primary contact for developing new service offerings that will meet these customers' needs. The second of these designated work groups is the interexchange Customer Service Center. It is responsible for processing all requests for access services and also performs all billing inquiry and collection functions associated with interexchange carrier accounts. Each of these groups shares the additional responsibility of ensuring that all interexchange carriers, whether large or small, receive fair and equal treatment.

Equal access implementation involves the application of new technology as well as new administrative processes. To provide equal access, Bell Atlantic must install newly developed software in its end office switching systems. As presubscription orders are received, the switching systems must be programmed to route presubscribed calls to the correct carrier. They must also be programmed to permit use of the 10XXX access codes for those interexchange carriers serving each end office. Additionally, Bell Atlantic must coordinate the design, installation, and testing of each circuit requested by interexchange carriers.

Since converting the first telephone switching office in the nation to equal access in Charleston, West Virginia on July 15, 1984, Bell Atlantic has successfully converted 222 offices. Bell Atlantic's aggressive equal access implementation schedule exceeds the divestiture decree requirement to convert one-third of access lines by September 1, 1985, and additional end offices upon bona fide request. As of September 1, 1985, Bell Atlantic has converted more than 40 percent of its access lines to equal access. By September 1, 1986, Bell Atlantic will have converted approximately 700 switching machines to equal access. At that time, more than 12 million access lines, which represent more than 80 percent of Bell Atlantic's total access lines, will have been converted.

We have set for ourselves an equally ambitious schedule for putting into service equal access tandem switches. Bell Atlantic has made tandem switch hardware and supporting software. Twenty-five tandem switches are already operational. Fully 86 percent of Bell Atlantic's end offices will be converted with tandem access available. On a going forward basis, beginning with the September 1, 1985 conversions, no lines will be converted prior to tandem availability.

At the start of 1985, more than 70 percent of all access lines in the region served by our telephone companies—and 95 percent of lines in our major cities—were served by electronic switching technology. By the end of 1985, switching for nearly 80 percent of our access lines will be electronic; by 1990, local switching is planned to be 100 percent electronic. In January, 1985, there were 63 digital switches in our territory, with 158 more to be added in 1985. Now and in the future, to meet the needs of our customers, all replacement switches will be digital or will incorporate advanced technologies to make the local network even more versatile and efficient than it is today.

That Bell Atlantic's telephone companies have been leaders in the application of electronic switching systems explains the very high percentage of our access lines that will be converted to easy dialing: of a total of 15 million access lines, more than 80 percent will be converted by the end of 1986.

Special mention must be made of the benefits that are accruing to the rural communities within Bell Atlantic's serving territory from our network modernization program. Using Bell of Pennsylvania as an example, this company pioneered the introduction of the 5ESS switch with one of the first three installations in the country at Bradford in late 1983. This switch brings access to Information Age services to very small communities and serves 1,000 customers as easily as 100,000. Again using Bell of Pennsylvania as an example, the community of Bellwood was the site of another technological breakthrough when a 5ESS remote unit went into service in January, 1985, after months of preparatory effort. Its ability to share the processor of the 5ESS switch cut over at the same time at Hollidaysburg made this machine economical for even this small town, which has only about 2,000 customers.

Bell Atlantic has given priority to implementing equal access in its 1ESS, 1AESS, DMS 100 and 5ESS switches because they are capable of being converted to equal access, are generally located in urban areas, and serve the most access lines. The larger switches in larger urban areas have been given preference in the scheduling.

Bell Atlantic plans to equip all switches of these types for equal access by September 1, 1986. It was necessary to schedule earlier conversion of offices in non-urban areas in order to fulfill the decree requirement to convert one-third of the access lines in each of our operating companies by September 1, 1985.

Now that our September 1, 1985 obligations have been met and the software has become available for converting other switches, we have greater scheduling flexibility. Accordingly, Bell Atlantic, in cooperation with the interexchange carriers, has developed a "clustering" schedule, with as many offices as possible within a metropolitan area converted in a five-week period. This clustering should allow more efficient media advertising by our interexchange customers. In addition, Bell Atlantic has undertaken an advertising program using television, radio, and newspapers in cluster areas to encourage customer choice.

Bell Atlantic has made available billing name and address information to help the interexchange carriers' marketing efforts. Other more recent changes aimed at the same goal include Bell Atlantic's offer to make nonpublished and nonlisted customer names and addresses available to the vendors who handle under contract the interexchange carriers' mailings of promotional material. Also, so that the interexchange carriers can verify that customers have received the carrier of their choice, we have developed several different reports that can be used for that purpose.

To help our subscribers through the transition to equal access, we have conducted numerous meetings with customer groups, mailed millions of customer education packages, and helped fund the Tele-Consumer Hotline, an independent consumer group specializing in providing information about telecommunications services. This effort will continue through 1986.

Lastly, mention must be made of Bell Atlantic's active participation in such national organizations as the Interexchange Carrier Compatibility Forum, the Ordering and Billing Forum, and the Network Operations Forum. The meetings held by these organizations permit the direct discussion of national network standards, as well as other issues of concern to both interexchange carriers and local exchange companies.

While we are making every effort to bring the benefits of long-distance competition to the public under the constraints imposed on us today, I would be remiss in failing to mention that even greater advantages could be realized by consumers if the Bell Atlantic companies were free to fully respond to consumer needs. The Bell Atlantic companies offer good telecommunication services to the extent that they are permitted under FCC and court rules. We are attempting to broaden these services through diversification. Our goal is to provide customers with another competitive option to fill their full communications needs. Our goal is to work with interexchange carriers to best serve other customers—the end users. Achievement of that goal will result in increased productivity, economic efficiency, and greater United States competitiveness in world markets.

None of this will occur, however, if the unique national resource—the \$125 billion invested today in the basic service network of the divested Bell telephone companies—cannot be utilized to the maximum extent. With little additional investment, this network, designed largely for voice, will be capable of innovative new offerings required to bring home the Information Age.

Constraints now artificially imposed by the divestiture decree and by the FCC disable the telephone companies from bringing required enhancements into the network—thus denying to millions the services of information providers. Uneconomic pricing policies now in place prevent the Bell companies from competing for the full range of services and giving their customers the benefits of efficiencies and low costs. Line of business, structural, and geographical (interLATA) constraints imposed upon these companies bear no relationship to market realities and seriously inhibit their ability to deliver the integrated services which customers demand. Archaic capital recovery policies inhibit the Bell companies' continued innovation and modernization of their plant.

Only by lifting or modifying these and other regulatory and judicial constraints can the potential role of the divested Bell telephone companies in the United States telecommunications marketplace—and the productive value of their \$125 billion in assets—be realized. By permitting the Bell companies to compete, the traditional leading role of the United States in the world telecommunications market can be maintained and enhanced.

What role can government play in the attainment of these important social goals? First, to assure the continued superior technical quality of the national telecommunications network, government should recognize that technological innovation is stimulated by a free market environment. There is a free market in exchange access, and bypass technologies will continue to be perfected. In order to retain ex-

change access customers, the telephone companies must also improve the functionality of their networks. Government must free the telephone companies of restrictions on the services they have provide that currently constrain research and development and innovation in the local exchange network. In addition, capital recovery policies must be made consistent with a competitive market, aligning depreciation to technological life.

Government must also recognize that the FCC's structural separation requirements prevent or delay introduction of new services, raise uncertainties which harm marketing efforts, and seriously inhibit the telephone companies' ability to respond to customer requirements. The divestiture decree prohibition also inhibit the telephone companies from competing. Bell Atlantic believes that the proliferation of structural separation requirements has not advanced the public interest. The FCC's Computer II restrictions make it particularly difficult to sell telephone company centrex services to customers, including the federal government itself, who demand single-source bids, i.e., bids for a complete system, including both switching and terminal equipment.

What can government do to provide more certainty and stability to both the telecommunications industry and the public? The primary source of instability in the industry is the fact that access charges are required by regulation to greatly exceed the cost and free-market bypass alternatives. Charges of this level will result in abandonment of telephone company access services, particularly by large customers who produce a disproportionately large amount of telephone company revenues. Access pricing policies must be aligned with cost, removing uneconomic subsidies, including artificial separations cost allocations, pooling requirements, and mandated rate averaging.

How can government address the special issues relating to rural telecommunications needs? Because telecommunications services in many rural areas cost more than in urban areas, government should assure that service is kept within economic reach of needy member of the public. Where this requires service to be provided below cost, subsidies should be financed by general tax revenues.

Lastly, what measures will help the U.S. telecommunications industry compete more effectively given growing foreign competition both at home and abroad? Bell Atlantic believes that an effectively competitive U.S. industry, without artificial pricing or unwarranted market restrictions, will provide healthy competition to foreign providers.

In summary, government should allow the divested Bell telephone companies to compete fully in the market place with no artificial constraints. Government should treat the Bell companies for what they are—potential innovators and competitors in the telecommunications market place.

Bell Atlantic wishes to thank the Senate Commerce Subcommittee on Communications for the opportunity to file this testimony.

STATEMENT OF TDX SYSTEMS, INC.

On September 5 and 11, 1985 this Subcommittee conducted hearings to examine competition in the long distance telephone market. As stated by Senator John C. Danforth there is controversy over what constitutes equal access and the provision of equal access facilities. TDX Systems, Inc. agrees and submits the following comments for the record.

TDX, a wholly owned subsidiary of Cable and Wireless North America, is an interstate common carrier with significant subscriber bases in the District of Columbia, California, Georgia, Maryland, Massachusetts, New Jersey, New York, Pennsylvania, Texas, Illinois, and Virginia. TDX also provides intrastate service in some of these states and therefore is an active competitor in the long distance telephone market.

TDX believes the industry is currently facing three problems in its transition to workable competition.

1. A misperception as to what constitutes complete equal access;
2. Strategic behavior on the part of AT&T which creates a barrier to entry for new firms; and
3. A proposal by the Federal Communications Commission to allow AT&T to price so-called optional Message Toll Service (MTS) according to a "guidelines" procedure. These guidelines would actually sanction strategic behavior by AT&T and threaten the development of workable competition.

I. EQUAL ACCESS

A. Background: Premium vs. Inferior Connection

An objective of the Modified Final Judgment (MFJ) was to ensure that the Bell Operating Companies (BOCs) provide Equal Access to Other Common Carriers (OCCs) and thereby eliminate earlier restrictions on the type of connection the OCCs had to the local loops. These restrictions, developed through the ENFIA agreements of the late 1970s, and codified in the Bell System's tariffs were line side or two wire connections; i.e., the same pair of wire was used to receive and transmit information—as opposed to a four-wire connection where the receive and transmit path are separated. Use of the two wire connection resulted in lower quality and further, did not provide automatic number identification (ANI) on the originating end of a call, nor did it provide answer supervision on the terminating end of a call. Accordingly, the OCCs were only able to offer a low quality service and one that required dialup of a local number, followed by an authorization code and then the actual long distance number—clearly impediments to the user—and a service that, without answer supervision, could not provide precise billing.

AT&T in marked contrast, was able to utilize premium access connections which had none of these problems.

The market for telecommunications services was therefore segmented by type of access connection. Economic theory indicates that such segmentation and unavailability of inputs to one entire sector of the market prevents that market from ever becoming fully competitive.

Recognizing this concept, the MFJ set up a time table for the provision of equal access to the OCCs. TDX, as did others in the industry, presumed that once Feature Group D was made available by the Local Exchange Companies (LECs), complete "Equal Access" would also be available.

B. Unforeseen Problems In Realizing Equal Access

Since the beginning of the equal access "conversion" process, a number of significant, unforeseen difficulties have arisen. Some have been addressed by the Department of Justice. The major issues which have been reviewed are the availability of Feature Group D through tandem connections and inefficiencies in the presubscription process.

While the operational aspect of the OCCs service was impacted very negatively during the first year of this conversion, recently the LECs have changed their conversion process so that, in the future, Feature Group D conversions will be made available via access tandems. This will, for the first time, eliminate the inefficiencies that the OCCs have contended with for the past twelve months. Once tandem conversions are the normal method of providing Feature Group D to the OCCs, and previously delivered lines from individual end offices are reconfigured to tandems, a hurdle to the availability of complete Equal Access will be eliminated.

As to the inefficiencies in the presubscription process, the Department of Justice took formalized action as indicated by their letter of June 25th to the Bell Operating Companies in which the Department noted several criteria that the BOCs needed to adhere to so that difficulties in the presubscription process did not prevent the OCCs from achieving equal access.

As has recently been reported in the trade press (Communications Daily, September 4, 1985) MCI has contended that the operating companies have failed to meet these various requirements. MCI's argument is that since the operating companies have not provided Feature Group D in a manner that permits the OCCs to truly have the same type of service that is available to AT&T—via difficulties in presubscribing customers—the operating companies have not provided complete equal access.

TDX has experienced problems similar to those cited by MCI and completely agrees with the thrust of MCI's recent statement. We would like, however, to call attention to another aspect of equal access—the provisioning and operating difficulties associated with Feature Group D connections.

TDX believes that complete equal access is not available until all of the provisioning and operational issues concerning its implementation are resolved.

For example, TDX has experienced difficulties with the provisioning and delivery of facilities from the LECs, a problem not experienced by AT&T due to its historic ability to acquire Feature Group C connections. TDX has also experienced significant difficulty with the operational aspects of Equal Access once delivered.

TDX has experienced a significant number of: high static, noise or transmission problems, calls which complete to a recording, Feature Group D calls not routed to the prescribed OCC, "high and drys", and "low levels" whereby the volume of the

call becomes so low the customer complains. There is also, in a number of Feature Group D areas, a significant connection lag problem (7-8 seconds), after the long distance number is dialed, before the TDX switch is reached. The comparable lag for AT&T is less than 2 seconds.

These problems have had detrimental effects on TDX marketing by creating the impression that TDX quality of service is suspect, and have had adverse financial implications in the short term. These financial damages include both the revenue lost when traffic is not able to be processed due to telephone company operational problems and cancellations due to customer dissatisfaction with service quality.

Such damage has weakened the OCCs during the critical transition to Equal Access.

C. Existing Problems in Equal Access

There are numerous problems in the operating environment that prevent the Feature Group D which is being made available by the operating companies to the OCCs from constituting complete equal access. These problems fall into the following two categories: provisioning difficulties and operational issues.

1. Provisioning Difficulties

TDX has experienced various difficulties in the delay of obtaining capacity from the LECs—both as to timing and quantity—which constitute major obstacles in the ability of TDX to offer complete equal access to its customers. When this capacity has been delivered from the local operating company TDX has experienced serious problems with the initial service quality and ongoing network management support being provided by the local exchange companies.

2. Operational Difficulties

There are five categories of operational difficulties that have occurred on a large proportion of TDX Feature Group D circuits. These are:

Completes To Recording. This is a condition that occurs immediately after a customer dials 1 or 1+ the long distance number. It is caused by the telephone company either not finding a vacant trunk or circuit to complete the call to the OCC, or problems with equipment or routing. The telephone company will give a fast busy signal or a recording indicating, to the OCC customer, a blockage of some nature. Some of these recordings recommend that the customer attempt the call at a later time. This is a problem very unlikely to occur for AT&T because facilities already are in place to serve most of the potential demand and alternate routing is available to circumvent momentary blockage in the primary path between the LEC and AT&T.

High Static, Noise or Transmission Problems. These impairments impede a customer's ability to have a reasonable "sound quality" over the public network. These impairments can occur at any time for a variety of reasons. However, AT&T protects itself by having the LECs frequently test their circuits for noise impairments, and if parameters are out of the prescribed limits, the circuit is removed for maintenance. The OCCs have only recently been afforded the same opportunity.

Feature Group D Calls Not Routed to the Prescribed OCC. This problem is caused by the telephone company not updating, or incorrectly updating, the translation information in their switching equipment that determines how each call should be routed. In as much as there is a change required from the present system in which AT&T receives all interLATA calls, if the change is not performed properly, only the OCC and the customer will suffer.

"High and Dry." This is a term indigenous to the telephone industry that depicts a situation where the customer performs all necessary steps to originate a call but nothing happens. There is no apparent explanation, but the difficulty often is the tone register that receives the input digits from the customer. If the register is malfunctioning, it may not recognize a proper tone or dial pulse and is unable to react appropriately.

"Low Levels." This problem results from a high loss of signal volume in the end to end provision of the call. It is a transmission impairment caused by the design of the circuit connecting the customer to the OCC. Although standard designs are used, parameters often change causing the volume to be reduced to the level where a customer complaint is generated. Once again, constant testing is the only way to prevent the occurrence of this problem. The severity of these problems to OCCs in general and TDX in particular are obvious. TDX has experienced these operational difficulties on 22.3 percent of its Feature Group D circuits. These problems are not experienced by AT&T and accordingly demonstrate that TDX has clearly not received complete equal access on these various circuits.

Complete equal access will only be provided to OCCs when all aspects of its service are available and operational in a routine manner. This is clearly not the case today.

II. AT&T'S STRATEGIC BEHAVIOR

An additional dimension of the current transition is that the post-divestiture market for switched services is not yet workably competitive and remains subject to possible strategic dominant firm behavior by AT&T Communications. As a dominant carrier, AT&T still possesses the market power to engage in strategic behavior that may disadvantage existing rivals and deter entrants from entering the market. Until complete equal access becomes widely available to all of AT&T's actual and potential competitors, Congress should not assume that AT&T's pricing and dominant firm conduct is a response to actual or potential competition.

A realistic assessment of the extent of competition in the long distance industry today requires a detailed, disaggregated view of the industry. Such a disaggregated analysis recognizes three major industry groups: (1) AT&T Communications providing premium quality service using its own facilities and premium local exchange interconnection; (2) OCCs providing a lesser quality service using inferior local exchange interconnection but attempting to construct their own facilities-based networks; and (3) Resellers combining their own switching capacity with leased common carrier transmission facilities and services. The barriers to entry for each strategic group, known as "mobility barriers", are vastly different. Market entry today for a reseller is comparatively easy, whereas entry for a facilities-based carrier providing a premium-quality service in direct competition with AT&T Communications is quite difficult.

Until complete equal access is more widely available to the competitors of AT&T, it is unrealistic to view competition from other strategic groups within the industry as an effective constraint on AT&T's existing market power. The appropriate model for predicting the current strategic behavior of AT&T and its effect on competition and industry structure and performance is the "dominant firm-fringe competitor" market model, not the models of workable competition or "contestable markets". As a dominant firm, AT&T Communications retain both the incentive and, more importantly, the ability to pursue strategic conduct that is consistent with long run corporate objectives.

Such dominant firm behavior focuses on both competition for customers and on shaping industry structure to the advantage of the incumbent dominant firm and to the disadvantage of potential entrants that may attempt to enter the dominant firm's strategic group. In other words, a dominant firm has both the incentive and ability to pursue strategies that increase the risk and cost of market entry by new firms. If credible, dominant firm behavior may successfully deter the entry of efficient competitors and constrain the growth of existing efficient competitors. As well-known economist Michael Spence has observed, "The established firm(s) want to position themselves in such a way that their self-interested reaction to a potential entrant is damaging to the entrant's profitability without being self-destructive. Such dominant firm behavior signals to potential or actual rivals that market entry or attempts to enlarge market share are likely to be met by a dominant firm response that will make such fringe competition unprofitable."

AT&T's current conduct, including its effort at market segmentation which its "Optional MTS" program represents, poses a major threat to the long term realization of workable competition in the interstate long distance transmission market. The increasing availability of equal access to the OCCs implies that the OCCs will begin to compete directly with AT&T Communications in its own strategic group. In other words, the availability of equal access means that the OCCs are being drawn into a new strategic group while simultaneously AT&T has an incentive to repel such entry by erecting higher mobility barriers. Thus, the OCCs confront a difficult marketing challenge, namely, convincing long distance subscribers during the process of conversion to equal access that their formerly lower quality service, is, after equal access, technically equivalent to service provided by AT&T Communications.

AT&T tariffs, such as the recently rejected PRO America, demonstrated a strategic attempt to narrow the existing price differential between OCC and AT&T while the OCCs are able to provide for the most part only a lower quality service. This dominant firm strategy results in many consumers feeling indifferent to subscribing to OCC services, especially before equal access is generally available to all interchange subscribers.

For these reasons, the immediate post-divestiture, pre-equal access era is a unique period in the history of the domestic telecommunications industry. If AT&T through such dominant firm pricing strategies as Pro-America can successfully deter the

entry of OCCs into its strategic group, it may maintain its dominance and market power for an indefinite period of time. If AT&T can build and maintain excess capacity during the pre-equal access era, it can successfully reduce prices to targeted user groups, meet the additional demand induced by such a strategy, and constrain the growth of the OCCs that must migrate to AT&T's strategic group as equal access becomes more widely available.

III. THE FCCS PROPOSED "OPTIONAL MTS GUIDELINES"

In light of the problems being experienced by the OCCs in obtaining complete equal access and AT&T's 85% to 90% of the interlata telecommunications market due to its previous monopoly position. TDX is concerned that the Commissions proposed "guidelines" will sanction strategic behavior on the part of AT&T.

There are two principal questions that we feel the Commission should address before implementing these "guidelines";

1. Whether AT&T's "optional MTS" service offerings can meet the Communications Act's requirements of just, reasonable, and non-discriminatory prices;
2. Whether marginal cost pricing is practicable and appropriate should any "optional MTS" services be deemed permissible.

The fundamental issue underlying these concerns is that the proposed "guidelines" would sanction new pricing schemes on the part of AT&T if the net revenue for all MTS service offerings increased as a result of the new pricing scheme. The difficulty in this approach is that it assumes that the repricing of AT&T's service—in and of itself—indicates that some type of new service is being made available to the market. Actually, "services" such as Reach-Out America and the recently rejected Pro-America are not new "services" at all, but rather strategic repricing of standard switched telephone service. Accordingly, the concept of marginal cost pricing—which applies to discrete services—is not an appropriate standard for an analysis of whether such a repricing scheme on the part of AT&T meets the criteria of the Communications Act of being just, reasonable, and non-discriminatory.

Rather, these "guidelines" would provide a vehicle for AT&T to further segment the market for switched telephone service and under the guise of "flexibility" provide FCC backing to repricing schemes that would be disadvantageous to the developing competitors. This is far different from allowing a competitive response on the part of AT&T.

This would be at a time when the OCCs are still restricted to selling an inferior type of service due to the difficulties in obtaining complete equal access. Rather, one could argue that such repricing—is a clear indication of the strategic behavior mentioned earlier.

The remaining concern in this regard, is that any repricing scheme—such as Pro-America—that is not fully compensatory, implicitly may involve a cross-subsidization from other sectors of the switched voice market. These sectors are particular market groups to which the OCCs have not yet been able to provide service such as many rural customers, 800 service, coin-paid telephone service, and service to a significant number of international locations.

As one witness pointed out during the hearing, approximately 80% of the customer base in the United States could not at the present time be served by the OCCs due to the capacity limitations which presently exist.

For these reasons, TDX feels that FCC approval of these proposed "guidelines" is completely inappropriate at this time, as it would be damaging both to consumers in the immediate term and, by hindering the development of the OCCs, further damage consumers in the long term since the development of a truly competitive market place would be affected.

IV. CONCLUSION

There are two policy implications that flow from the problems which have just been described. First, there must be a recognition on the part of the Department of Justice, the Divestiture Court, and the FCC, that the availability of Feature Group D through the conversion of telephone company switches (both end offices and tandems) does not constitute complete equal access. Accordingly, there must be an improvement in the monitoring provisions of telephone company activities in this regard, as well as more defined standards as to what constitutes equal access.

Secondly, there is a need for explicit recognition on the part of the FCC that the problems which the OCCs are experiencing with Feature Group D capacity is significantly preventing the development of a competitive market place. Without complete operational equal access the OCC's are not able to provide—on a certain and reliable basis—the same type of service which has historically been provided by AT&T.

The access being made available to OCCs is different (although not necessarily better) than the traditional ENFIA connections, but in no way constitutes service "... equal in type, quality, and price to that provided to AT&T and its affiliates".

Accordingly, the Commission must find that these access differentials are preventing the development of a truly competitive market place. This fact, in combination with the market dominance of AT&T clearly demonstrate that any thought of deregulating AT&T at this time, whether explicitly acknowledged or backed into under the guise of providing "flexibility" to AT&T is a significant detriment to the ultimate development of competition.

During this conversion period and the final stage of the routine operation of Feature Group D the FCC should adhere to the statement by the National Telecommunications Information Administration (NTIA) in its recent study entitled "Issues in Domestic Telecommunications, Direction for National Policy" which states that "... it is especially incumbent upon the FCC to continue its close scrutiny with respect to proposed substantial AT&T price reductions as the conversion process continues."

Accordingly, any pricing "flexibility" for AT&T that is in any way based upon "competitive necessity" is totally inappropriate and unjustified. Regulatory policy based on the presumption that equal access is rapidly becoming available to the OCCs needs to be replaced by an actual determination of the degree of competition that exists and with a corresponding corrective mechanism to facilitate LEC implementation of complete equal access. Only when complete equal access is in place should the FCC begin to deregulate AT&T's pricing behavior.

STATEMENT OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS

This statement is submitted for the record to the Subcommittee on Communications of the Senate Committee on Science, Commerce, and Transportation on behalf of the National Association of Regulatory Utility Commissioners (NARUC).

Founded in 1889, the NARUC is a quasi-governmental, nonprofit organization whose members include regulatory bodies of the fifty States, the District of Columbia, Puerto Rico and the Virgin Islands. Designed to serve the public interest by seeking to improve the quality and effectiveness of government regulation of carriers and utilities, its members play a crucial role in shaping the profile and substance of public regulation in America today.

The members of the NARUC greatly appreciate the opportunity to express our views on AT&T oversight and competition in the long distance telephone market. As regulators of telecommunications services, our particular objective is to preserve universal telephone service at affordable rates for all citizens. Many long distance telephone calls made in the United States today are intrastate interLATA calls. Moreover, policy decisions concerning long distance telephone competition made in the courts, by Congress, and the Federal Communications Commission (FCC) ultimately have an impact on all users of telecommunications services, whether or not they use the long distance telephone network.

I. DIVESTITURE AND THE ACCESS CHARGE DECISION

Perhaps the most far-reaching event in the history of telecommunications in this Nation was the breakup of the Bell System. The rationale underlying divestiture was that all long distance telephone users would benefit from competition in the long distance market. This basic tenet was underscored by Judge Greene in the Modification of Final Judgment (MFJ) in *United States v. American Telephone and Telegraph Company*, 552 F. Supp 131 (D.C.C. 1982), aff'd sub nom *Maryland v. United States*, 103 S. Ct. 1290 (1983).

In addition to restructuring the Bell System, the MFJ requires each Operating Company to provide to all other common carriers (OCCs) exchange access on an unbundled, tariffed basis that is "equal in type, quality and price to that provided to AT&T and its affiliates". The equal access requirement was intended by the court to redress the control exerted over the BOCs by AT&T which tended to preclude competition in the long distance market.

While the court delineated the responsibilities of the BOCs and AT&T as implementing equal access and guaranteeing certain unrecovered costs of implementation, respectively, the FCC announced that it would implement a monthly subscriber line charge as a means of recovering non-traffic sensitive (NTS) local exchange costs. Although the FCC argued that the resulting increase in local phone rates would be offset by reduced long distance toll rates, the NARUC strongly opposed the charge, arguing in Congress and in court that because the charge is not tied to use

of the interstate network by telephone subscribers, it amounts to a local service charge to subsidize OCC use of local telephone facilities used to complete long distance calls. The NARUC predicted that assessing costs in this manner would ultimately threaten universal service. Nevertheless, the subscriber line charge was implemented.

As the dust continues to settle from divestiture, the NARUC finds potential for further impairment of universal service in the form of reduced regulation of AT&T.

II. COMPETITION IN THE LONG DISTANCE MARKET AND DEREGULATION OF AT&T

The NARUC strongly believes that reduced regulation of AT&T should not be implemented until it has been affirmatively demonstrated that 1) reduced regulation will neither impair universal service nor result in financial hardship or inconvenience to telephone subscribers, and 2) competition is sufficiently robust to enable AT&T's competitors to flourish.

Although it has been twenty months since divestiture occurred, competition sufficient to warrant deregulation of AT&T, particularly reduced rate regulation, is still nonexistent. Many rural areas still lack competition in switched services, some without any OCCs or resellers operating in these areas. Indeed there is significant doubt as to whether this country's rural areas will ever enjoy the benefits of competition in the interstate Measured Toll Service (MTS) market. In these parts of the country, continued rate regulation of AT&T remains the sole effective method of avoiding monopolistic pricing for Measured Toll Service by AT&T.

In high-traffic urban areas, where AT&T faces the most competition, the potential for AT&T to engage in toll rate deaveraging is substantial without continued rate regulation. AT&T could use its substantial market power to underprice competitors in these markets, driving the OCCs out of business. AT&T would have abundant incentive to recover these costs by raising its MTS rates in low traffic, sparsely populated rural areas. Such an increase would result in decreased MTS usage in rural areas; decreased usage would result in higher intrastate costs which, in turn, would most likely be recovered through higher local exchange rates. Increased local exchange rates would result in significant drop-off from the telephone network.

Similarly, reduced rate regulation in the form of pricing flexibility in selective geographic areas, such as urban, high traffic areas would impair universal service. First, the only practical way areas could be designated for this alternative is by LATA. However, use of LATAs is problematic because even some of the most densely trafficked urban LATAs, such as the Washington, D.C. and Philadelphia, Pennsylvania LATAs, contain sparsely populated rural exchanges. The same rate deaveraging problem as outlined above would therefore be created, albeit on a smaller scale. Second, selective application of "pricing flexibility" would create cross-subsidization problems. Service in unregulated areas would be subsidized by revenues earned from the provision of service in regulated areas.

Reduced regulation of AT&T could also result in improper reliance on market forces to ensure that each of AT&T's rates is cost-justified. There is a likelihood that this approach could result in predatory pricing or practices.

In the past, the FCC has indicated that such conduct could be checked by the FCC's complaint process and antitrust relief Notice of Inquiry, October 27, 1985, para. 35. The NARUS believes, however, that the preservation of universal service cannot be adequately accomplished through privately initiated administrative and judicial enforcement. Indeed, the failure of the antitrust laws to provide timely relief and adequate rate supervision underlies the existence of many regulatory agencies today, see, Priest, Principles, & Public Utility Regulation; (Michie Corp. 1969) Vc. 1 pp. 16-23.

III. CONCLUSION

The NARUC is concerned that further deregulation of AT&T at this time will potentially impair universal service. Even if AT&T were to refrain from toll rate deaveraging to price below cost in high traffic areas, AT&T might still engage in monopolistic pricing in sparsely populated, noncompetitive parts of the country. These artificially high rates would threaten universal telephone service as outlined above. Similarly, further deregulation resulting in predatory pricing by AT&T, inadequately redressed through administrative and judicial remedies, would also impair universal service.

Accordingly, the NARUS respectfully urges members of the Subcommittee that deregulation of AT&T, particularly reduced rate regulation, not occur until it has been affirmatively demonstrated that (1) it will neither impair universal service nor

result in financial hardship or inconvenience to telephone subscribers, and (2) competition is sufficiently robust to enable AT&T's competitors to flourish.

STATEMENT OF PACIFIC TELESIS GROUP

In recent years, tremendous resources have been expended divesting the former Bell Operating Companies from American Telephone and Telegraph Company (AT&T) and introducing competition into interexchange telephone service markets. This expenditure was imposed in the hope of expanding consumer choice and lowering prices for interexchange telecommunications products and services.

Recently however, statements by "other common carriers" (OCCs) indicating that interexchange competition may be in jeopardy have raised concerns over whether this nation's telecommunications goals will be achieved. Pacific Telesis Group¹ (Pacific) wants to assure the Subcommittee that Pacific is also concerned that the nation's telecommunications goals² be achieved, and is committed to carrying out its responsibilities for ensuring that all interexchange carriers (IECs) have the opportunity to compete on a fair and equal basis.

As part of its commitment, Pacific Bell had converted 4.1 million telephone lines over to equal access by June 30, 1985, representing 37% of its total lines and exceeding the MFJ requirement that 33 1/3% be converted by September 1, 1985. In addition to exceeding this requirement, Pacific has taken various voluntary actions to make its equal access conversion process more beneficial to IECs. These actions, which include clustering equal access conversions and providing access tandem digital switches, are discussed below.

In approaching the interexchange competition issues, Pacific urges public policymakers to avoid ad hoc, piecemeal decisions and the undesirable side effects and distortions which they bring. The telecommunications/information processing industry should be viewed as a whole, with an eye to the complex relationships between the OCCs, AT&T, the computer industry, the local operating telephone companies (OTCs), including Pacific Bell and Nevada Bell, and most importantly, the end user telecommunications customers. Any decision whose purpose is to solve individual problems of one group of competitors is likely to cause very troublesome problems for the others and for consumers.

In considering these matters, Pacific believes that public policymakers should keep in mind that competition has been injected into interexchange markets not as an end in itself but as a means of achieving benefits for consumers. The methods used to stimulate competition must be carefully chosen so as to avoid jeopardizing achievement of the very goals which all are seeking.

BACKGROUND—THE DECLINE OF THE BOTTLENECK

Although Pacific does not provide end to end interexchange telecommunications services, it plays an important role in the interexchange market. It provides local exchange services and connects end user customers to IECs who in turn provide an array of interexchange telecommunications and information services.

These local exchange access services have been characterized as "bottleneck" monopolies. The emergence of bypass technologies has greatly reduced the so-called bottlenecks of the local OTCs. In rural areas, the bottlenecks have remained intact because reasonably priced, profitable alternatives for service do not exist. On the other hand, in urban business areas, the bottlenecks are rapidly eroding because competitors find it economically attractive to provide alternative systems. The local OTCs benefit society by providing service where no one else will.

AT&T and the OCCs are rapidly positioning themselves to help large end users bypass local OTCs through direct connections to their networks. Some of AT&T's

¹ Pacific Telesis Group was formed in late 1983 just prior to the divestiture of the Bell System and is a diversified telecommunications services provider. It includes Pacific Bell and Nevada Bell which provide intraLATA voice, data, and video services through the "core" telecommunications network; Pacific Bell Directory, which publishes the Yellow Pages; and the PacTel Companies which include PacTel Mobile Companies, PacTel Communications Companies, Pacific Telesis International, PacTel Publishing, PacTel Finance, PacTel Services, and PacTel Properties.

² The nation's communications goals are set forth in Section 1 of the Communications Act of 1934 (47 U.S.C. § 151), in part as follows: "to make available, so far as possible, to all the people of the United States rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges." Thus, benefits to the public are the goals, not competition or regulation per se.

bypass plans are described below. Another example is MCI which, through its Cable Phone Division, interconnects its long distance network with various institutional cable television networks across the country to receive and deliver end users' communications without the use of local OTC networks.

Bypass has undermined and made obsolete many public policy decisions which were premised on the continued existence of bottlenecks. These policies include the overpricing of toll services and of access to long distance services in order to subsidize local rates. Other policies undermined by the decline of the bottlenecks include federal restrictions on the provision of information or enhanced services and limitations on lines of business which can be pursued by local OTCs and those companies which own them, the regional holding companies (RHCs). The diminished bottlenecks do not justify preclusion of OTC involvement in these new services.

The most recent example of attempting to use the supposed existence of bottlenecks as a basis for decisions is the joint petition to the FCC by GTE Sprint, U.S. Transmission Systems, U.S. Telecom, and Allnet Communications Services seeking regulatory changes including:

"A requirement that the [former] BOCs convert OCC access arrangements to Feature Group D (FGD) on a LATA wide basis and with tandem switches in place or, alternatively, to require the OCCs to pay FGD rates only when such facilities are in place."

Adoption of this ad hoc proposal would have the direct effect of prolonging the OCC access charge discount, resulting in continuation of higher access charges on AT&T. This represents yet another example of encouraging decision making based on the mistaken belief that local OTCs act as bottlenecks and can charge customers whatever amounts policymakers decide will be of benefit to particular segments of the industry. As discussed below, adoption of the OCC proposal would not increase competition but would instead encourage increased AT&T bypass of local OTC facilities, thereby causing increases in local telephone rates for consumers and jeopardizing reasonably priced universal telephone service.

Rather than basing public policy on the protection of interexchange competitors through the manipulation of pricing structures, Pacific believes that policymakers should carefully consider the needs of end users and how to allow the delivery of the services which they desire. Reliance should be placed on voluntary, cooperative arrangements between local OTCs and IECs which can facilitate such delivery. These arrangements include the provision by local OTCs of access tandem digital switches, forecasting and marketing information, and clustering of equal access conversions. Pacific's activities in these areas are described in the next section.

PACIFIC IS TAKING STEPS TO HELP SUSTAIN INTEREXCHANGE COMPETITION IN CALIFORNIA AND NEVADA

Pacific benefits from having many strong, viable customers for its interexchange access services. Aware of this and recognizing that different IECs have different access requirements, Pacific has been developing a variety of services. Each interexchange carrier is able to select what is appropriate for its needs.

Some services are extremely helpful to the OCCs. For instance, Pacific has pursued an aggressive policy of providing access tandem digital switches. Without the provision of digital tandem capability, IECs can fully use equal access services only if they construct or lease direct facilities to every local exchange company end office through which they wish to receive or deliver calls. Tandem switches can be used to aggregate low volumes of traffic to high volume levels and avoid using inefficient and less cost-effective direct connections. In addition, Pacific's digital access tandem capabilities are designed to provide IECs with greater performance and reliability through the very latest in telecommunications technology.

Pacific has been rapidly activating access tandem digital switches since January of this year. By June, Pacific had activated switches in ten areas of the state, including the large metropolitan areas of Los Angeles, San Francisco and San Diego. Since then, Pacific has added five more areas, and by the end of the year Pacific intends to have fully developed access tandem switches in every LATA.

Furthermore, Pacific has established a task force of Marketing, Network and Operations personnel to provide IECs with assistance in forecasting in order to improve their ability to order appropriate access line capacity and avoid unnecessary charges or shortages. Pacific is also supplying appropriate marketing information, including default lists and customer information related to non-presubscribed 10XXX dialed long distance calls.

In addition to these steps, Pacific has changed its schedules for implementation of equal access in metropolitan areas to allow nearly all the residents of entire cities

and communities to make their choices between long distance carriers during the same time frame. This approach, which involves clustering of conversions to equal access, decreases confusion which occurs when one neighborhood in a city converts long before another. IECs benefit because they are able to reach potential customers more effectively and at lower costs through the use of mass media.

These types of arrangements, and others being explored, which IECs and local OTCs can work out across the nation, are part of the rapidly changing telecommunications environment which is facilitating the development of interexchange competition. In light of these developments, the legislation or further changes in regulation sought by some OCCs are unnecessary.

ALTHOUGH PACIFIC SHARES THE OCCS' CONCERNS, WE CANNOT SUPPORT THEIR PROPOSALS FOR ALLEVIATING THEM

The transition to a fully competitive interexchange marketplace is understandably a difficult one for many of the OCCs. AT&T has reduced its rates, and to be competitive the OCCs have had to follow. Further, as they receive access from local OTCs which is equal in type and quality to AT&T's access, the OCCs incur increased access charges that are equal to those charged to AT&T. With lower prices and higher costs, some OCCs face cash flow difficulties.

As a result of these difficulties, certain OCCs have joined together in a petition to the FCC requesting, among other things, the continuation of the OCC transitional access charge discount until Feature Group D access services are available on a LATA-wide basis with tandem switches in place. This would prolong the discount far beyond the equal access time limits established by the ongoing MFJ process and previous FCC orders. It would discriminate in favor of the OCCs, allowing them to benefit from discounted equal access to the larger exchanges in each LATA during the time it takes for the smaller exchanges to be converted. There is no reason why the OCCs should continue to pay discounted rates while receiving access which, from their customers' perspective, is equivalent to that provided to AT&T.

In addition to being unfair, prolonging the OCC discount is unnecessary and would cause distortions in the industry. Pacific has voluntarily provided tandem connections and clustering of equal access conversions. These cooperative types of arrangements deal with the IECs' legitimate needs and avoid ad hoc, piecemeal Governmental actions not related to the total fabric of complex service and pricing arrangements which have developed over time in the telecommunications industry. In such an environment, ad hoc decisions which focus on one problem create new problems. In the situation at hand, the proposed continuation of the discount for OCCs, which would theoretically be offset by higher access charges for AT&T, would provide AT&T with an additional incentive to bypass. Therefore, the effect of prolonging the OCC discount would be that the local OTCs and their remaining customers would bear the cost of attempting to make the interexchange market competitive.

The following actions taken by AT&T demonstrate that it has the current ability to bypass and already has a large incentive to do so:

The FCC has approved tariffs filed by AT&T Communications (AT&T-C) which allow it to terminate so-called direct connections from its points of presence in each LATA to end users without using any exchange carrier facilities. Merrill Lynch and AT&T recently announced plans to bypass NYNEX through connection of such service in New York.

Starting in 1986, AT&T will begin providing dial tone and billing capability in its network. When these capabilities are combined with direct connections or private line type connections to the end user, AT&T can easily become the end to end provider of services to customers without use of the OTCs' switched networks.

AT&T is building a number of new points of presence in California. This will situate AT&T closer to Pacific Bell's central offices, significantly reducing AT&T's access charge transport costs, but also duplicating portions of Pacific's network and stranding Pacific's plant. This strategic move by AT&T will also place it closer to large business customers so that it can more easily provide them with direct access to its services.

AT&T has requested approval from both the FCC and the California Public Utilities Commission to provide software defined networks (SDN). SDN will primarily utilize dedicated special access or direct connections to AT&T's public switched networks, simulating private line networks and encouraging additional service bypass.

Although Pacific supports the addition of intelligence to the switched network, SDN would result in additional losses of revenue for local OTCs, particu-

larly since AT&T is seeking authorization to compete with local OTCs for intra-LATA services by completing intraLATA calls over SDN. Approval of SDN as filed would set a precedent for the development of alternative networks that essentially replicate existing local OTC switched networks, but which deprive the local OTCs of common non-traffic sensitive (NTS) costs.

AT&T has just proposed its MEGACOM services to the FCC. These new services are essentially WATS and 800 services with the important difference that special access and direct bypass connections are used to access AT&T's switched network. No new technology is being introduced; rather this is another example of AT&T attempting to find ways to continue to use its switched network but not pay for the recovery of common NTS costs.

It is Pacific's policy and intention to continue to work with all IECs to bring new services to market for the benefit of all consumers. In addition, Pacific has been striving diligently to obtain pricing arrangements and flexibility at both the federal and state levels which will lessen the incentive for uneconomic bypass. There has been some initial success in this area. However, current pricing structures which have developed over many years, and to which the local OTCs are legally bound, make opposition to uneconomic bypass services necessary at this time. The OTCs' pricing structures contain subsidies and obligations aimed at protecting the nation's universal service goals. For instance, it costs Pacific Bell an average of about \$29 a month to provide local service to residential customers, but Pacific charges an average of about \$9.25 per customer for the service. The difference is provided by pricing toll services and long distance access services well above cost. This makes these latter services easy targets for competitors now that bypass technologies have led to the reduction of any OTC bottleneck advantage. As the AT&T examples above illustrate, competitors can add facilities and services which duplicate those already provided in the OTCs' networks and which would be uneconomic if local OTCs were free to compete.

Until pricing structures provide local OTCs with the freedom to more fully compete with bypassers, bypass will remain a serious problem because, as the number of high volume toll customers remaining in the core network decreases, each remaining customer must pay increasing amounts to cover NTS network costs. Given the local OTCs' large NTS revenue requirements and pricing recovery mechanisms based largely on switched access usage, IECs and large business customers are diverting their usage away from the network. This will ultimately drive the costs of supporting the network onto those least able to avoid the costs or to pay them, namely, residential and small business customers.

This being the current situation, an increased AT&T bypass incentive could jeopardize reasonably priced universal telephone service. The longer that AT&T is required to pay a premium access charge, the more likely it is to fully deploy its bypass capabilities. Therefore, Pacific recommends that the transition period from discount rates to full rates be allowed to proceed and be generally completed by September of 1986 with the completion of the MFJ equal access transition schedule.

In the event that policymakers decide to extend the OCC discount and maintain a premium access charge for AT&T in order to stimulate increased competition between the OCCs and AT&T, then Pacific believes it is essential that they also take action to ensure the intended result is actually achieved. AT&T would need to be restricted from using bypass services which would allow it to simply avoid payment of the access premium and common non-traffic sensitive costs. This could be accomplished by requiring all IECs, including AT&T, to originate and terminate all traffic through the facilities of the local OTCs. In addition, when the IECs' switched networks are used, it would be necessary to require use of the OTCs' switched access services.

THE TREMENDOUS CHANGES OCCURRING IN THE INTEREXCHANGE MARKET SHOULD BE ALLOWED TO CONTINUE FOR A REASONABLE TIME BEFORE DECISIONS ARE MADE AS TO WHETHER INTEREXCHANGE COMPETITION IS WORKING

All can agree that the purpose of introducing competition into interexchange markets was not to benefit competitors but rather to benefit consumers. Therefore, Pacific believes that policymakers should not judge progress in the industry by narrowly looking at whether particular carriers are incurring losses, but should take a broader view as to whether the industry is moving in the direction of providing consumers with a larger selection of high quality services at reasonable prices.

The industry is in such an extreme state of flux that a narrow view cannot create a sound basis for even ad hoc, piecemeal decision making, and a broader, comprehensive view is not yet possible. The prospects of a particular OCC can change

almost overnight through a merger or alliance with others. The recent announcement by MCI and IBM that they plan to form an alliance, the more recent announcement by Allnet and Lexitel that they plan to merge, and the even more recent announcement by GTE Sprint Communications Corporation and US Telecom, Inc. that they plan to share fiber capacity along some of their transmission routes, demonstrate this rapid transition of the industry.

The proposal by some OCCs that their access charge discount be prolonged until LATA-wide clustering and tandem access are available represents an attempt to set public policy based on a narrow view of the industry at a specific point in time. The individual problems of these carriers can be better addressed through voluntary, co-operative actions, such as those being pursued by Pacific and described earlier in this paper. Such actions can be flexibly applied so as to keep up with changes in the industry.

The rapid fluctuations in the interexchange market make it impossible at this time to achieve the broad view necessary to determine whether consumers will derive all of the benefits they should in that market. However, emerging competition in the interexchange market is revealing certain facts about the ability to compete in the telecommunications industry as a whole. First, it requires a great deal of capital. Second, it requires the combining of talents and the converging of services. As a result, the transmission and information processing industries are consolidating through alliances.

For example, AT&T is rapidly forming alliances which include:

Time Inc., Chemical Bank, and Bank of America (Covidea Corp.) for videotex services;

Quotron systems for financial information services;

Philips for central switching equipment;

C. Olivetti and Co. and Convergent Technologies for personal computers;

Amdahl for computer software and communications networks;

Mitsui and Company for data communications services; and

Digital Research for software marketing.

And, IBM's alliances include:

MCI-SBS for long distance service (pending);

Merrill Lynch International Marketnet for financial information services;

CBS and Sears (Trintex) for videotex services;

Intel for semiconductors;

Rolm and STET for telecommunications equipment; and

Mitsubishi for data communications services.

These alliances and others have completely blurred the traditional distinction between communications transmission services and information processing services. Customers now want and need a single service provider that can both process and transmit information.

The necessity to consolidate resources, in order to compete effectively and provide the public with the services they want, need not lead to a telecommunications market dominated by a few large providers offering new services primarily to large business customers and the ultimate stifling of competition. However, that is exactly what is happening, because federally-imposed restrictions are preventing many of the most experienced, financially strong parties from competing.

Obviously, one of these parties is Pacific. The RHCs are restricted by the FCC's Computer Inquiry II separate subsidiary requirements associated with enhanced services and customer premises equipment, and by the MFJ prohibitions on providing information services and limitations on conducting businesses unrelated to local telephone service.

Simply put, these restrictions are having an effect on competition opposite from that which was intended. These constraints were placed on the former Bell operating companies in a different technological and structural environment and were premised on their possession of monopolies of bottleneck local exchange facilities. The examples we have provided of AT&T's and MCI's plans to bypass the local OTCs and the proliferation of private bypass networks demonstrate the rapid erosion of these bottlenecks.

Restricting market participation by severely constraining the RHCs deprives customers and the nation of the benefits which can be gained through strong competitors capable of acquiring capital and combining all the talents and technologies needed to bring forth advanced products and services. Further, this restrictive approach ignores the reality that as domestic corporations are held back, large foreign corporations will fill much of the void.

Rather than restrictive policies, America needs a positive national policy to deal with the growing trade deficit in electronics-based products, an almost \$12 billion

shift from surplus to deficit since 1982. Current restrictive policies give foreign corporations an unfair advantage. They are free to sell telecommunications and information processing equipment in the U.S., but RHCs are not allowed to compete with users of that equipment in the provision of many intraLATA services.

Allowing the RHCs to compete without the burden of structural separation restrictions in the provisions of intraLATA services which combine information processing and telecommunications transmission technologies would offer vigorous competition to large domestic and foreign corporations. This would help provide multiple choices and reasonable prices for all residential and business consumers, particularly smaller and rural ones which other providers may not find it attractive to serve for some time, if ever.

CONCLUSION

Pacific supports the opportunity for all IECs to compete for interexchange traffic on a fair basis and will continue to work with them as customers to satisfy their needs. Pacific recognizes that this period of transition to interexchange competition is a particularly challenging one for many IECs. However, the rapid changes taking place in the industry counsel against ad hoc, piecemeal governmental actions aimed at protecting particular participants. This is especially important because of the close interrelationship between the various participants in the industry whose complex service and pricing arrangements have been coordinated in order to provide quality service at reasonable prices for all residential and business consumers across the nation. Governmental action should be taken or not be taken depending on its effect on this coordinated structure, since decisions not related to the total fabric will create severe distortions.

A decision made regarding interexchange competition will inevitably affect local operating telephone companies and their customers in material ways. For instance, were the FCC to decide to continue AT&T's premium charge for access by prolonging the OCC discount, that decision could effectively help sustain interexchange competition and avoid jeopardizing reasonably priced universal telephone service only if other measures were adopted as well. IECs would have to be required to originate and terminate traffic over the networks of the local OTCs, and to use the OTCs' switched access services when the IECs provided service through their switched networks. Otherwise, AT&T could avoid premium charges by directly connecting to large customers and bypassing local OTCs, in turn causing OCCs to increase their bypass facilities to improve their pricing margins as compared against AT&T's. This bypass spiral would reduce OTC revenues, causing increased local rates for smaller subscribers remaining on the core network.

The voluntary, cooperative arrangements which IECs and local OTCs are developing across the nation are fostering the growth of interexchange competition and making governmental action unnecessary at this time. These types of arrangements, together with the rapid formation of alliances, are part of the rapidly changing telecommunications environment which should be allowed to develop further before comprehensive decisions are or can be made by public policymakers as to whether interexchange competition is producing the full range of possible benefits for consumers.

STATEMENT OF THE INTERNATIONAL COMMUNICATIONS ASSOCIATION

Mr. Chairman and members of the Communications Subcommittee, my name is Brian R. Moir. I am pleased to have been invited to submit testimony on competition within the long distance telephone market on behalf of the International Communications Association ("ICA") in my capacity as Washington counsel of the ICA Public Policy Committee.

You, Mr. Chairman, the members of your Subcommittee, and your staff are to be commended for your efforts to pursue the interests of telecommunications users in developing sound domestic common carrier policy. In light of the changes created by the divestiture of the Bell system and recent Federal Communications Commission ("FCC") actions, your job has become more complicated.

Unfortunately, the Chairman of ICA's Public Policy Committee, Mr. Robert E. Bennis, Communications Systems Manager of Westinghouse Electric Corp., who has testified before this Subcommittee in the past, will be unable to testify today. With your permission, we request that this written testimony be submitted for the hearing record. Also, if it should please you or members of your Subcommittee staff, we will be available to receive written questions, and will attempt to respond promptly.

THE INTERNATIONAL COMMUNICATIONS ASSOCIATION

The ICA is the largest and most broadly-based organization of telecommunications users in the United States. The ICA represents large corporate, governmental and educational users of telecommunications services and equipment whose yearly individual expenditures in this area are over \$1 million. The ICA, whose approximately 550 members spend collectively over \$15 billion on telecommunications, is recognized by industry and government alike as the preeminent organization of its kind. It exists for the advancement of professional and scientific knowledge in the telecommunications field. Typically, ICA members have large intercity voice and data transmission networks. Entities which are predominantly engaged in the production, sale, or rental of telecommunications services or equipment are excluded from membership in the ICA.

TESTIMONY

As a consequence of divestiture, every communication manager during the last 2 years has been required to deal with at least one, and probably all, of the following problems: (1) increased "rate churn" caused by rapidly changing prices for intrastate and interstate common carrier services and facilities; (2) supplier turnover; (3) wider variations in the quality of services and equipment; (4) complicated procedures for ordering, maintenance, and other support services; (5) service provisioning delays; and (6) more rapid obsolescence of user investment in older technologies as new innovations appear.

In the face of such turmoil, it is not surprising that some users currently doubt whether all the changes brought about by the combined effects of divestiture, deregulation and pro-competitive policies will, on balance, benefit them. However, ICA believes that in the long run the vast majority of users will come to appreciate the greater service diversity and cost savings that are likely to result from emerging competition. And, regardless of how communications managers may currently feel about whether divestiture has been worth it so far, there is one fundamental principle that should guide Federal and State government policy makers in dealing with this complicated new environment: to act prudently and cautiously during the ongoing transition to a more competitive environment.

ICA cannot stress this too strongly. Many users believe, for example, that had the policy makers followed this advice, they would have required AT&T and the BOCs from the outset of the divestiture transition to devote more resources and trained manpower to the preservation of predivestiture service levels. Users can only hope this type of practical mistake will not be repeated again and again as several major policy issues affecting user rates and services are addressed by Federal and state policy makers in the next few years.

In the case of the FCC, the single most important issue before it is how to regulate AT&T and the exchange carriers for the foreseeable future. Multiple proceedings are already in motion which will substantially affect both the rate levels for services and the number of service and equipment providers. And, because there is overwhelming evidence that users do not yet have reasonable alternatives to AT&T and the exchange carriers in many cases, it is critical that the FCC not move too quickly to remove regulatory protections for users, both large and small.

Specifically, the FCC is considering in CC Docket No. 83-1147 the degree of regulation it should exercise over AT&T in the near future. ICA and others have already demonstrated in their filings that the time is not ripe to discontinue rate and service regulation of AT&T or to relieve it entirely from the requirements of the Computer II rules. ICA's position is grounded in the conclusion, based on considerable market analysis, that a workably competitive market does not now exist or seem likely to emerge in the foreseeable future. ICA believes deregulation is simply unthinkable until all service problems are resolved and equal access is fully and fairly implemented.

Moreover, as a practical matter, there are already signs that equal access may prove to be the death knell for many resellers and other would-be competitors of AT&T Communications. Witness the recent demise of SBS and the merger of Allnet and Lexitel. Some Federal policy makers may view this as nothing more than a normal market "shakeout." However, the reality to the user is that service alternatives are decreasing.

Also before the FCC are issues involving possible changes in the Computer II structural separation requirements which now require AT&T and the BOCs to conduct unregulated competitive activities through separate subsidiaries. ICA approaches this proceeding with a broader perspective than that of the competitors of

AT&T and the BOCs. That is, ICA will closely examine the workability, fairness, and effect of the FCC proposals on the using public.

In particular, ICA will closely look at proposals to ascertain whether they unduly favor AT&T or the BOCs over other providers of equipment and services. ICA would oppose any proposal which requires basic service ratepayers to subsidize AT&T and BOC competitive unregulated offerings. Such a state of affairs could harm competition in the vital enhanced service and equipment markets, or keep users' basic service rates at artificially high levels. Similarly, ICA will closely examine the FCC proposals to determine their impact on Integrated Services Digital Networks ("ISDN"). Many users are already concerned about the cost of ISDN implementation, and would not favor policies which lead to users' bearing even more costs.

The BOCs and AT&T have gotten a good jump on advocating removal of Computer II structural separation requirements. Indeed, some users would agree with them that the FCC's Computer II rules have not always struck an appropriate balance between insuring availability of new services (e.g., Custom Calling II) and accomplishment of other regulatory goals. But when the issues are examined in a fair and prudent manner—as they must be—ICA believes it will become clear that the FCC must be very careful not to thwart, through abrupt deregulatory action, the very competitive forces it professes to encourage. Should the FCC decide to remove the Computer II structural separation requirements altogether, or otherwise relax its regulation of AT&T and/or the BOCs, it must at the same time put in place sufficient safeguards to prevent or minimize potential anticompetitive and other harms to the public interest.

ICA also believes the FCC's determinations on Computer II and the regulatory treatment of AT&T and the BOCs could have important legislative implications. For example, should the FCC proceed hastily or overzealously to deregulate AT&T and/or the BOCs to a point where there is real prospect of a return to the days of more limited service options and economic choices, ICA would not be very surprised to see blocking legislation considered in both houses of the Congress.

Unfortunately, whenever telecommunications legislation is introduced, each industry segment tends to pursue special legislative treatment at the expense of other segments. For example, if legislation were to be considered, ICA would expect the BOCs to petition the Congress for relaxation in the restrictions imposed by the Modified Final Judgment on the lines of business which they may enter. AT&T, the OCCs and even the states could likewise be expected to petition Congress for special relief. In doing so, many of these parties may attempt to impose on large users, i.e., ICA members, the increased costs that could result from the enactment into law of their special treatment. As such, these legislative initiatives in the near future could have a far reaching effect on the costs and availability of services and equipment.

There is one final area of increasing concern to ICA and its membership: developments at the state level. The importance of state regulatory or legislative matters is often overlooked. Nonetheless, the same issues (e.g., deregulation and access charges) are being, or will be, considered by state regulatory commissions and, in many cases, by state legislatures. Moreover, the business-as-usual issues (e.g., rate increase requests and wholesale revisions to rate structures) continue to be an increasing problem at the state level.

As a specific example, ICA sees little evidence that the exchange carriers will abandon their efforts to take advantage of post-divestiture confusion and related changes by exacting unprecedented rate increases at the expense of users. At the same time, it appears that many exchange carriers are committed to blocking intra-LATA competition and to making life difficult for privately owned and operated user systems, which they disparagingly label as "bypass". Interestingly, each state has shown a tendency to resolve the issues differently, depending on their particular circumstances. With this in mind, ICA has initiated a study to determine how user concerns can be best represented in the state arenas.

In sum, divestiture and other deregulatory actions have confronted users with many problems and fundamental changes in their way of doing business. Although emerging competition brought about by divestiture and other pro-competitive policies is welcome news to users, ICA believes we have not yet reached a point where total deregulation of either AT&T or the exchange carriers is justified or even politic. ICA therefore urges Federal and state policy makers to be prudent and cautious during the transition to a more competitive industry. After all, it is the using public who will pay most dearly in an environment characterized by limited choice and limited government protections.

We have attached ¹ copies of four recent ICA pleadings to the FCC on issues of direct relevance to the subject of your hearings today:

ICA Comments in FCC CC Docket No. 84-800 (Authorized Rates of Return for the Interstate Services of AT&T and the Exchange Carriers);

ICA Comments in FCC CC Docket No. 83-1147 (Long-run Regulation of AT&T);

ICA Comments in FCC CC Docket No. 84-1235 (Guidelines for Dominant Carriers' MTS Rates and Rate Structure Plans); and

ICA Comments on AT&T's Megacom Tariff Filings.

QUESTIONS OF THE COMMITTEE AND THE ANSWERS OF MR. RULE

Question 1. What is your assessment of the current state of the long distance marketplace?

Answer. As discussed in more detail in the prepared remarks of Mr. Rule, the Department of Justice believes that the transition to equal access is the most important event currently underway in the long distance marketplace. At present, the Bell Operating Companies have completed necessary conversions of end office switches for more than one-third of the telephone lines served by their networks, and will complete the process of conversion to equal access for most switches by September 1986. The transition has led to a substantial increase in the level of competition in the long distance marketplace resulting in lower prices for consumers.

Question 2. What are your views on regulation or deregulation of this industry?

Answer. The Department of Justice has been at the forefront of efforts to deregulate industries where competition is viable. We believe that for most industries, reliance on market forces, not government regulation, will provide the highest quality products to consumers at the lowest possible prices. It is particularly important in the telecommunications industry that regulation not be permitted to blunt competitive forces and thus diminish the incentives for technological innovation.

With respect to AT&T, the divestiture was intended, in part, to permit AT&T to be deregulated. Thus, we believe it is not a question whether or not AT&T should be deregulated, but when such deregulation should take place. During this time of transition to deregulation, AT&T should be given flexibility to make pricing decisions based on its own business judgment rather than on regulatory constraints. This is because price reductions and new services are generally beneficial to consumers and should not be discouraged by unnecessary regulation. We recognize, however, that during this time of transition to equal access, some minimal regulation is necessary to insure that AT&T does not engage in truly predatory pricing that would threaten long term competition in the industry. We believe that the "net contribution to revenue" standard as recently adopted by the FCC will, if strictly enforced, permit sufficient scrutiny to detect any anticompetitive pricing that may occur and still allow procompetitive pricing flexibility that will benefit consumers.

Question 3. Do you think the FCC has acted too quickly in permitting AT&T pricing flexibility such as in its Reach-Out America decision?

Answer. No. We believe that the FCC has adequately dealt with the issue of AT&T pricing flexibility in its decision concerning Guidelines For Dominant Carriers' MTS Rates and Rate Structure. In that decision, the Commission expressed its belief that the guidelines "constitute a policy statement designed to prevent anticompetitive behavior while allowing dominant carriers increased pricing flexibility."² That decision is generally consistent with the Department's view that during the transition to equal access, AT&T should be subject to some minimal regulation necessary to insure that it does not engage in truly anticompetitive pricing that would threaten long term competition in the industry.

Question 4. Do you think the FCC should complete its inquiry into the state of the long distance market in the long run deregulation of AT&T, Docket No. 83-1147, before adopting its proposed pricing guidelines?

Answer. In its MTS pricing guidelines inquiry, the FCC assumed that AT&T had substantial market power, but that consumers would benefit if AT&T had pricing flexibility because of increasing competition in the interexchange marketplace. Since the inquiry into the state of the long distance market and the long run regulation of AT&T was, in part, designated to determine whether AT&T had market

¹ The attachments have been retained in the Committee files.

² In the Matter of Guidelines for Dominant Carriers' MTS Rates and Rate Structure, CC Docket No. 84-1235, Memorandum and Order at 4 (October 17, 1985).

power, it was not essential for that inquiry to be completed before the FCC took action with respect to its proposed flexible pricing guidelines.

Question 5. There have been some problems in implementing equal access: for example, some customers have been connected to a long distance carrier other than the one they chose. Are the Bell Operating Companies meeting the equal access requirements of the divestiture decree?

Answer. The Department of Justice is currently pursuing an investigation of the Bell Operating Companies (BOCs) conduct under the Modification of Final Judgment entered in the AT&T case. On June 25, 1985, Acting Assistant Attorney General Charles F. Rule issued a letter (copy attached) to the BOCs setting forth the Department's views concerning what the MFJ required of them in connection with the equal access process. In addition, the letter requested the BOCs to provide the results of audits of 5% of the end offices converted to equal access. The Department is in the final stages of its consideration of the responses to that letter. The Department is aware that there have been some problems with the implementation of equal access, but believes that many of the problems have been ameliorated by changes instituted by the BOCs in response to our letter, as well as by the substantial improvement and simplification of the process by the FCC when it ordered a ballot process.

Question 6. Do you anticipate recommending to Judge Greene any changes in the equal access schedule?

Answer. No. It appears to us that the BOCs have met the one-third requirement in terms of the physical conversion of end offices to equal access, and that any necessary corrective steps can be taken to insure that the ordering process is sufficiently accurate to cause customer choices of a primary interexchange carrier to be properly instituted into the end office switches being converted.

Question 7. When will you complete your inquiry into how equal access is proceeding?

Answer. The Department expects to complete this inquiry in the near future.

Question 8. You refer in your testimony to the recent move of the local Bell Telephone Companies to open their switches to providers of information services. Could you elaborate on this move toward open architecture and to what it means for users and for competition in the information services market?

Answer. The Department believes that most, if not all, information services can be provided competitively and are not a natural monopoly service that would require regulation. Essential to the competitive offering of such services, however, is adequate access to end users by information service providers through the BOCs as well as other local telephone companies. In connection with proceedings initiated before Judge Greene by certain of the BOCs, the Department pointed out that a subsidiary of one of the BOCs, NewVector, was willing and able to provide collocation within its cellular switch to allow information service providers to offer voice storage and retrieval services on a competitive basis. We believe that this is a positive step that will permit consumers to benefit from new information services, and is an indication of the possibilities that exist for all BOCs to provide equal access to information service providers.

The Department amplified its views on this issue in connection with the FCC's Third Computer Notice of Inquiry,³ where it stated that, if the BOCs can provide open architecture, it may be appropriate to consider a change in the MFJ's restrictions on BOC provision of information services.

Question 9. In your testimony you talk about the benefits of competition in the interstate market. There have, however, been many increases in the intrastate toll rates. Have you looked into this situation and what it means for competition in the long distance industry?

Answer. The MFJ has helped to facilitate competition in the interstate market as well as the inter-LATA market within states. The MFJ, however, does not require that state jurisdictions permit competition for intra-LATA toll service. Rather, the MFJ appropriately leaves to state regulation the appropriate charges for intrastate intra-LATA toll service. Because this is a matter for a state jurisdiction, the Department has not specifically investigated any such rate increases. There are many causes of rate increases, including adjustments in depreciation schedules and new capital costs. Such increases cannot go into effect, however, unless approved by state public utilities commissions. Many local operating companies, including some BOCs, have resisted competition for intra-LATA service, including intra-LATA toll service.

³See, Amendment of Section 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry), CC Docket No. 85-229.

It could be anticipated, however, that competition for such service would lower prices.

Question 10. Recently, there has been considerable discussion in Kentucky about allowing South Central Bell to provide long distance service over the entire state, rather than just within exchanges ("LATAs"). This is proposed to help assure that rural customers have competing long distance services rather than AT&T service only. Do you see any problems with this after equal access is available?

Relatedly, what about offering long distance services outside the local RBOCs region?

Answer. The continued need for restrictions on the BOCs' ability to engage in interexchange service will be examined in the Department's report to be filed with the Court in January 1987. At that time, the Department will have the benefit of information concerning the appropriate implementation of equal access, as well as information concerning the state of competition both in the long distance marketplace and in the provision of local telephone service.

After the implementation of equal access, and in connection with the Department's report to the Court, we will also examine whether it would be appropriate to permit the RBOCs to offer interexchange services outside their regions.

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